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EVALUATION OF THE AID 1983-1984

STRUCTURAL ADJUSTMENT PROGRAM IN KENYA

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PREFACE

The evaluation mission consisted of Elliot Berg (Elliot Berg Associates), Walter Hecox (Colorado College) and James Mudge (Agency for International Development). The mission was in Kenya for most of the month of April 1985. We did preparatory work in Washington, in mid-March and completed the draft report in May, after our return to the U. S.

To allow coordination and at the same time to allow a full airing of each team member's findings and recommendations, we tentatively decided in Nairobi to prepare "working papers" on each of the four main groups of "program outputs" we were evaluating. The assumption at that stage was that the mission leader could then integrate the separate assessments. In fact, this proved impossible to do, mainly because of time pressures and the dispersion of the team in the U.S. For this reason, the "working papers" idea was abandoned, and the papers are included integrally in the report. This causes some overlap and may have made the report longer than absolutely necessary. After our return from Kenya, Jim Mudge reorganized and edited the report, with the present volume being the result.

The recommendations in the report are of course a joint product of all the team members. We came to a consensus on most issues. The recommendations were worked out in close collaboration with Embassy and USAID staff. The Country Team was truly generous with its time and insights; staff will see many of their own ideas here. On the logistics side, the mission's help was superb. Ms. Joan Wagner and Ms. Julie Osawo deserve special thanks. They arranged our calendars and orchestrated our work, and they did it with uncommon competence, patience and good humor.

Elliot Berg
Alexandria, Virginia
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ANNEX A - Summary of Major Agreements Making Up the SAP

GLOSSARY OF ABBREVIATIONS

AID	Agency for International Development
ATH	Africa Tours and Hotels
cif	(shipping) costs, insurance and freight
CIP	Commodity Import Program
CP	condition precedent
DA	Development Assistance
ESF	Economic Support Fund
FAC	Fertilizer Advisory Committee
FCC	Fertilizer Coordinating Committee
GDP	gross domestic product
GMS	Booker-Githongo Grain Marketing Study
GOK	the Government of Kenya
IAPC	Investment Advisory Promotion Center
IBRD	International Bank for Reconstruction and Development (the World Bank, the Bank)
IMF	International Monetary Fund, the Fund
ISIC	International Standard Industrial Classification
KCB	Commercial Bank of Kenya
KEDRES	Kenya External Debt Reporting System
KFA	Kenya Farmers Association
KGGCU	Kenya Grain Growers Cooperative Union
KIDRES	Kenya Internal Debt Reporting System
KTDA	Kenya Tea Development Authority
LDC	less developed country
MFP	Ministry of Finance and Planning (the Treasury)
MOLAD	Ministry of Livestock and Agriculture Development
NCPB	National Cereals and Produce Board
PHS	Plant Hire Service
PL 480	Public Law 480
QR	Quantitative Restriction
SAL	Structural Adjustment Loan (program)
SAP	Structural Adjustment Program
SDR	Special Drawing Right (an IMF unit of account)
SOE	Stated Owned Enterprise
TAP	Technical Assistance Pool

UNDP	United Nations Development Program
USAID	United States Agency for International Development (the AID Mission in Nairobi)the AID Mission in Nairobi

Note: An exchange rate of 15 Ksh per U.S. dollar was used to convert Kenyan shilling figures to dollar figures. The 15:1 rate is approximately the average 1982-1983 rate.

SUMMARY

This report is an examination of two years of a three-year AID Structural Adjustment Program (SAP) in Kenya during 1983 and 1984. The $117 million program began in June 1983 with a $30 million grant in Economic Support Funds (ESF). In 1984 $33 million was provided under the SAP. Three program documents--agreements between the GOK and AID--are the core documents for this examination.

The Kenyan economy was confronted with several problems in 1983 and 1984 which the SAP sought to address: the economic repercussions of the coup attempt in August 1983 and the cumulative effects of structural weaknesses. Reflecting the situation, the AID policy dialogue, program support and associated conditionality were particularly directed toward helping the GOK in its economic stabilization efforts in 1983 with a shift in emphasis in 1984 toward structural adjustment objectives.

The main purpose of this exercise is to examine the two-year program to help indicate what should be done in Kenya for the next phase and to attempt to extract some lessons pertaining to policy dialogue and conditioned economic assistance. The report is not an impact evaluation. It looks at some of the basic premises of the 1983-1984 SAP and it considers whether the policy problems chosen for reform or change reflect a reasonable ordering of priorities. The report examines the "effectiveness" of the policy dialogue, the degree to which the GOK has complied including performance beyond nominal compliance. Overall, the paper looks at whether the SAP in on the right track, and to the extent that it is not, proposes modifications for the next phase.

Chapters 2 through 5 contain the analysis of the main areas of the SAP: economic stabilization and reduction of trade barriers; liberalization of fertilizer distribution and maize marketing; institutional reforms--budgeting and parastatals-; and population. Chapter 6 summarizes the assessments in the preceding four Chapters and Chapter 7 contains an assessment of the nature and quality of the policy dialogue and the reform performance beyond specific conditions.

Findings

There are some unambiguous positive results. Although not an explicit part of the SAP, the program significantly contributed to achievement of two major objectives: the SAP made a major contribution to the GOK's successful economic stabilization effort and to reinforcing Kenyan-U.S. political ties. For four years previous to 1983 the GOK had been unable to achieve the stabilization goals under IMF auspices. The 1983 effort might also have been a failure without the

gap-filling $28 million cash grant the U.S. provided in June 1983. The ensuing stabilization effort is a policy success story: the annual inflation rate and the budget deficit were cut by about one-half; the real effective exchange rated was brought down; the real interest rate was increased and there was a sharp reduction in foreign borrowing and in the current account deficit.

On the political side, relations with the GOK were cemented by AID's prompt provision of flexible and large-scale assistance. The SAP became a significant element in the bundle of mutual commitments that now characterize U.S.-Kenyan relations.

A third achievement of the SAP was liberalization of fertilizer marketing. Private distributors for the first time have access to donor-financed fertilizer in open competition with government entities. This is the most significant liberalization move made by the GOK in recent years.

The SAP yielded mixed results with respect to efforts to accelerate institutional development and liberalize trade. On the positive side of institutional development there have been numerous accomplishments in the budgeting and financial management process. There has been wide application of microcomputers under the auspices of the SAP-financed technical assistance pool (TAP) in the Ministry of Agriculture and Livestock Development (MOLAD) (and a similar program in the Ministry of Finance and Planning but under a DA financed project). In-service training in MOLAD has been introduced and operational capabilities improved. A compendium of development projects has been prepared for the first time and steps have been taken to enable the GOK to improve its monitoring of internal and external debt.

The results in the institutional area are mixed because, in spite of abundant, high-quality technical assistance, the recipient institutions continue to be relatively limited in indigenous analytic capacity and they still have fragile procedures for project generation and investment allocation and management.

The objective of trade liberalization has been to reduce trade barriers, particularly import restrictions on manufactures, and thereby lessen the bias against the agriculture sector and exports. On the positive side the real exchange rate has been reduced. Facilitated by SAP-financed technical studies, some imports have been moved from quota restriction to a tariff basis and average tariffs have been reduced. Import procedures have been streamlined and the volume of imports has increased.

The negative side is the relatively slow pace of trade liberalization. Export procedures remain complex and cumbersome; numerous quantitative restrictions persist; the target of automaticity in approving import license requests has not been achieved and most manufacturing activities remain relatively insulated from foreign competition.

The GOK agreed to waive all import duties and taxes on family planning commodities in accordance with a covenant in the SAP. No other progress was made in this area, however.

The major failures of the SAP have been in maize marketing and in divestiture of parastatals. No liberalization of maize marketing has taken place. There has been a gradual tightening of government controls since 1980; this trend has continued into 1985. Even limited divestiture of state-owned enterprises has not occurred.

Recommendations

1. There is no adequate justification for a reduction in the prescribed program level, but there are reasons for deep concern about Kenya's slowness in addressing structural problems.

2. AID should not give up efforts to obtain structural reforms. Although difficult to achieve, the consequences of no reform are too important to Kenya's future to ignore.

3. Change the composition of the SAP:

   -- increase use of off-budget projects in the AID Kenya program;
   -- consider financing private undertakings to provide services;
   -- revise the technical assistance strategy in a way to decrease Kenyan reliance on foreign advisors.

4. Deemphasize explicit conditionality in policy dialogue; instead concentrate the dialogue on reducing Kenya's objections to change and on understanding the bases for Kenyan objections.

5. Consider asking the GOK to prepare its own program terms similar to the approaches employed by the IMF (Letter of Intent) and the World Bank (Letter of Development Policy).

6. Concentrate the dialogue on:

   -- gaining further liberalization in fertilizer marketing;
   -- making population policy a more central issue.

Lessons

The major lesson from the experience in Kenya is that excessive stress had been placed on conditionality, creating expectations which were unlikely to be realized and, perhaps more important, which tended to deflect the policy dialogue away from the fundamental and substantive issues.

It is becoming increasingly evident that there exist clear political limits on the use of hard conditionality. Explicit conditionality has little to do with most of the actual obstacles to policy change. The policy reform effort and policy dialogue should be targeted more directly on the reduction of underlying objections to change.

If conditions are thought to be necessary or advantageous, they should be limited in coverage, and "process conditionality" should be minimized.

1. INTRODUCTION

1.1 The AID Structural Adjustment Program

The report contains an examination of the first two years of the AID three-year Structural Adjustment Program (SAP) in Kenya. The SAP was initiated in June 1983 with a $30 million Economic Support Fund (ESF) grant to the GOK. The purpose of the SAP was to provide approximately $109 million in balance of payments support with the balance going to fund consultancies, studies and acquisition of microcomputers and associated software.

The 1983 grant was made in one installment providing $28 million in foreign exchange and $2 million for technical consulting services to support implementation of the program. The Ministry of Finance and Planning (MFP) is the the GOK entity responsibe for implementation of the SAP. The grant agreement contained seven conditions precedent and eight covenants which are summarized in Annex A.

The 1984 the contribution to the SAP took the form of a $13 million DA-funded Agricultural Development Program loan to import fertilizer from the U.S. and a $21 million ESF-funded grant. The latter program consisited of $15 million for commoditiy imports and $6 million for technical advisory services.

1.2 Economic Background

Official Development Assistance from all sources to Kenya has grown appreciably in the past decade, from an annual average of about $140 million in the mid-1970s, to an average of $450 million in 1980-1983. Table 1.1 shows this evolution.

The U.K. and the Federal Republic of Germany were the largest bilateral donors through the 1970s and the International Development Association (World Bank) was the largest multilateral source of development assistance. In the 1980s, the U.S. became the largest single donor when the U.S. average annual share of total bilateral assistance doubled between the last half of the 1970s and the early 1980s (9.0 percent average, 1976-1979 to 17.9 percent average, 1980-1983). The average U.S. share of total assistance to Kenya increased from 6.3 percent to 13.6 percent (see Table 1.2).

Much of the U. S. aid to Kenya is now in the form of policy-based "nonproject" loans and grants. The breakdown for 1982 through 1985 is shown in Table 1.3. The shift to policy-based lending is explained in part by the unpromising prospects for development projects; there are now over 700 projects in Kenya, many of them without adequate funding for operating and maintenance costs. The shift is explained also by the new awareness of the need for assistance in an effort to accelerate policy reform and structural change.

The Kenyan economy experienced a distinct slow-down in the 1970s, after a decade of rapid post-independence growth. Some of this was due to unfavorable external circumstances (oil price increases, the East African Community break-up). But much of the economic slump was related to domestic policy deficiencies and structural blockages that the shocks of the 1970s brought to the surface. The structural problems were recognized in many government documents: Fourth Development Plan, 1979-83; Sessional Paper Number 4 of 1980 on Economic Prospects and Policies, and the Sessional Paper Number 4 of 1982, Development Prospects and Policies.

It was on the basis of these and similar statements of government policy that the World Bank and the GOK worked out the Bank's two Structural Adjustment Loans (SALs). The AID Structural Adjustment Program has the same bases. The diagnosis of the structural problems facing the Kenyan economy are clearly set out in the documents relating to both institutions' structural adjustment programs.

First, according to a World Bank assessment, Kenya's industrial growth had been built on weak foundations. As a result of excessive protection against foreign competition, favorable treatment with respect to taxes and credit, and distortions induced by investment incentive legislation, most of Kenyan industry is high cost and capital intensive. It is a heavy net consumer of foreign exchange. Given other demands for foreign exchange this is a fragile and undesirable situation. It can only be remedied by opening up the economy to the winds of import competition.

Second, agricultural growth had slowed down (Table 1.4). The two main growth sources of the sixties were no longer providing large increases in output by the early 1970s: conversion of the larger holdings to intensive smallholder cultivation, and spread of hybrid maize. By the mid-1970s, the negative factors had come to dominate: an overvalued exchange rate that discouraged agricultural exports; relatively low producer prices in the official marketing channel; government interventions in marketing that increased risk and uncertainty, increased instability, and exacerbated price differentials by preventing free movement of maize within the country. A major objective of structural reform in agriculture was to liberalize maize marketing and pricing.

Third, the public sector had grown too fast; resources were being inefficiently used by government. Government activities had proliferated, via new or expanded parastatal activity. Better planning and control of expenditure was needed, and some lower-priority parastatal activities had to be cut back. Divestiture of some nonstrategic, money-losing parastatals was desirable.

Fourth, rapid population growth was threatening the country's resource base and straining budgetary resources by growing claims on expenditures for health, education and other services. Nonagricultural job creation could not come close to absorbing potential new entrants into the nonagricultural labor force. These were the main structural blockages that were the focus of the World Bank's SAL and USAID's SAP. (The Bank was also concerned with energy pricing and programs).

In brief, the AID SAP is aimed at relieving five major bottlenecks to faster growth: inadequate economic decision making and management; a too inward-looking and inefficient industrial structure; excessively interventionist agricultural policies; a too big parastatal sector; and a too passive population policy. It also aims at reinforcing economic stabilization policies such as are included in the GOK's stand-by arrangements with the IMF--credit restraints, reduction of budget deficits, control of foreign indebtedness. A description of the three major agreements making up the SAP is provided in Annex A.

1.3 Study Scope and Organization

The scope of this study was initially set out by USAID Nairobi and refined in subsequent discussions with the country team staff. The results are summarized below:

- The study is not an impact evaluation in any conventional sense, that is, it does not attempt to measure the AID SAP in terms of its direct and indirect impact in moving the Kenyan economy to a higher growth path, or its impact on the economy's achievement of medium-term external and internal balance. It is too soon to try such an evaluation. (The SAP is only two years old.) And it is too difficult in any case to disentangle the AID program's impact from that of other donors, notably the IMF and the World Bank. It is also not practically feasible to take account of external factors in measuring relative causes and effects.

- The general objective of the evaluation is to determine whether the SAP is on the right track, and if not, how its next phase might be modified. The study gives priority to this latter aspect--to the future. Efforts to assess the program's past are intended to provide insights as to what should be done in the next phase.

- The study pays close attention to "significance," the question of whether the choice of Kenyan policies to be reformed reflects a reasonable ordering of priorities. The evaluation also examines the "effectiveness" of the policy dialogue.

Five specific questions guide the assessment. They are as follows:

- Are the program outputs well-chosen? Do they address fundamental blockages to renewed economic growth and structural change? Are they suitable elements for conditionality?

- How good has the policy dialogue been, in terms of number of people involved, frequency and duration, intensity of interchange of ideas? This refers to process not to substance.

- Has the related technical assistance (TA) been an output well-linked to the dialogue process and to policy reform objectives? Does the policy reform-linked technical assistance encourage (or retard) the growth of Kenyan policy analysis capacity.

- How well has the GOK complied with the conditionality specified in the SAP agreements?

- Have the SAP reform proposals and related compliance measures been well-chosen and well-defined? Are they

technically sound and consistent with other AID projects or other donor programs?

The SAP has nine "program outputs"--targeted improvements in institutional performance or economic policy--which are listed as follows.

1. Improved analysis, planning, budgeting and financial management in the Ministry of Finance and Planning (including donor projects.)
2. Improved functioning of financial markets.
3. Improved functioning of external markets.
4. Improved functioning of agricultural input markets.
5. Improved functioning of agricultural output markets.
6. Improved analysis, planning, budgeting and financial management in the Ministry of Agricultural and Livestock Development.
7. Improved implementation of family planning policies and programs.
8. Reduced government participation in parastatal organizations.
9. Increased reliance on the private sector to achieve development objectives.

For analytic convenience the program outputs are grouped into four chapters as follows:

- Chapter 2 - Reforms in the trade regime, industrial policy and financial markets;
- Chapter 3 - Agricultural policy reforms;
- Chapter 4 - Institutional reforms (improved analysis, planning, budgeting, divestiture of parastatals, encouragement of the private sector);
- Chapter 5 - Family planning policies and programs.

Table 1.1. Kenya: Official Resource Flows[a], 1974-83
(millions of U.S. dollars)

Year	Official Development Assistance	Other Official Flows	Total Official Flows		ODA as a Percent as Total Gross Official Flows
			Gross	Net	
1974	129	...	...	...	...
1975	141	...	...	...	...
1976	175	97	272	247	64
1977	179	89	268	217	67
1978	289	94	383	327	76
1979	369	92	461	415	80
1980	413	98	511	464	81
1981	466	87	553	498	84
1982	503	124	627	568	80
1983	418	123	541	482	77

[a] Disbursement basis. Includes flows from DAC, OPEC and EEC countries, and from Multilateral Organizations.

Source: OECD. Geographical Distribution of Financial Flows to Developing Countries, Paris, various years 1979-85.

Table 1.2. Kenya: Commitments of Gross Official Development Assistance by Donor 1976-1983
(Millions of U.S. Dollars)

	1976	1977	1978	1979	1980	1981	1982	1983
BILATERAL								
Australia	2.0	1.5	1.9	4.8	3.4	6.0	7.1	2.6
Austria	0.1	0.7	0.7	3.5	0.5	0.2	0.1	0.2
Belgium	1.3	1.4	1.6	2.7	1.7	-	1.6	1.7
Canada	6.8	5.0	9.4	80.9	6.4	3.0	29.5	6.7
Denmark	12.5	10.2	24.2	28.6	15.5	5.0	37.0	17.6
Finland	0.1	0.8	0.2	6.9	3.0	6.7	10.1	15.6
France	-	-	11.1	-	1.8	25.7	23.8	14.3
Germany, F.R.	22.0	15.4	69.2	53.4	65.9	42.6	95.3	13.6
Italy	0.5	0.4	0.4	0.3	0.3	2.2	1.6	10.6
Japan	2.5	7.3	29.0	16.0	50.7	14.7	46.1	57.4
Netherlands	14.5	40.3	38.9	44.2	53.1	29.7	51.3	25.6
New Zealand	-	-	-	-	-	-	-	-
Norway	8.0	18.1	14.0	26.5	25.7	9.9	23.1	15.4
OPEC Countries	-	-	25.7	-	30.2	24.4	41.2	2.1
Sweden	14.6	35.9	33.8	44.3	-	22.4	22.3	17.1
Switzerland	1.6	5.1	2.4	1.0	1.0	8.4	8.8	3.6
United Kingdom	77.6	34.0	15.2	221.0	35.9	39.9	42.8	33.0
United States	7.7	33.6	34.3	25.4	60.3	44.0	68.9	82.8
TOTAL:	171.7	209.6	312.1	560.2	355.3	284.5	510.6	319.5
U.S. Share (%)	4.5	16.0	11.0	4.5	17.0	15.5	13.5	25.9
MULTILATERAL								
AF.D.F.	-	-	9.6	-	-	8.0	27.4	6.3
E.E.C.	1.0	46.9	59.7	3.5	7.5	37.5	34.4	14.1
IBRD	-	5.0	-	-	-	-	-	-
IDA	27.0	36.0	61.0	79.5	69.5	46.1	137.0	37.0
I.D.B.	22.0	-	-	-	-	-	-	-
IFAD	-	-	-	17.1	-	0.2	-	5.9
UN Agencies	10.5	6.6	8.5	12.3	16.9	19.6	21.8	15.4
Arab OPEC Agencies	5.0	8.1	5.4	-	4.0	3.0	12.0	-
TOTAL:	65.5	102.6	144.1	112.3	97.8	114.4	232.6	78.6
EEC & Members	129.3	148.5	220.3	354.3	181.5	182.5	287.8	130.4
GRAND TOTAL:	237.2	312.2	456.2	672.5	453.1	399.0	743.3	398.2
U.S. Share (%)	3.2	10.7	7.5	3.8	13.3	11.0	9.3	20.8

Source: Ibid.

Table 1.3. Assistance to Kenya 1982-1985
(U.S. Fiscal Years - Millions of Dollars)

U.S. Assistance	1982	1983	1984	1985[a]
Economic Assistance	59.3	81.5	72.0	80.3
Development Assistance	28.2	40.6	32.3	12.0
Economic Support Fund	10.7	30.0	21.0	30.0
Food for Peace	17.4	16.9	13.8	33.4
Other	3.0	4.0	4.9	4.9
Military Assistance	33.1	21.7	23.6	21.7
Total	92.4	103.2	95.6	102.0
International Agencies	168.0	237.9	298.0	n/a
Bilateral Assistance (other than U.S.)	296.0	276.6	n/a	n/a

[a] estimated

Sources: AID, Congressional Presentation, Fiscal Year 1986, Main Volume and Annex 1, Africa.

Table 1.4 Average Annual Growth Rates of GDP and Major Sectors
(at Factor Cost in Constant 1976 Prices)
(percent)

Sector	1964-72	1972-81
Gross Domestic Product	7.9	4.6
Agriculture	6.2	3.4
Industry	12.4	5.3
Services	7.8	5.3
GDP Per Capita	4.2	0.6

Source: World Bank, World Development Report 1985, Tables 2 and 19.

2. TRADE, INDUSTRY, BALANCE OF PAYMENTS AND FINANCIAL MARKET REFORMS

2.1 Introduction

Structural reform of the Kenyan economy has been a stated objective of the GOK since the mid-1970s and reaffirmed repeatedly since then in official documents. Substantial success has been achieved in the area of demand management. Less successful has been progress towards more fundamental supply-related structural rigidities.

The commitment to reform and fulfillment of an orderly timetable for implementation are fundamentally a Kenyan responsibility. Policy implementation schedules have slipped and the GOK has retreated in some cases from stated objectives. Although it is the responsibility of the GOK, not donors, to formulate and initiate fundamental reform, it is also important to recognize that Donors have their own guidelines and objectives in providing program support for structural reform. If GOK actions do not coincide with donor objectives and requirements, then the assistance related to structural reform may not be forthcoming. A mismatch of views on what constitutes adequate progress towards reform underlies much of the friction and doubt between GOK and donors over structural adjustment in Kenya.

Kenya signaled official concern and presented a concerted plan of action for structural adjustment of its economy in Sessional Paper No. 4 of 1980 on Economic Prospects and Policies. Although the Fourth Development Plan (1979/80 through 1982/83) covered many of the same issues and concerns, the 1980 Sessional Paper articulated concern over structural drift in the economy across a broad front and specified a comprehensive framework of policy responses:

The economic problems confronting Kenya are inter-related. The balance of payments constraint is closely linked to the budgetary constraint; and both constraints operate to limit overall growth of the economy as well as the availability of resources required to support various social welfare and public investment programmes. No single initiative or policy action will be sufficient to deal with these problems. What is required is a comprehensive set of mutually supportive policies that work in various ways toward the specified objectives.

The policies that have been formulated to guide Government's response to our economic problems are grouped for purposes of discussion in the following categories:

(i) international economic policy;
(ii) monetary and fiscal policies;
(iii) incomes and wages policies;
(iv) industrial policy;
(v) agricultural and food policies;
(vi) energy policy.

Even sharper focus on structural issues is found in Sessional Paper No. 4 of 1982 on Development Prospects and Policies, which succinctly described the interrelated nature of the various policy initiatives planned.

The policies discussed below are intended to cope with the immediately pressing financial and foreign exchange problems described above and to provide a firm setting for renewed economic growth. Those policies of long-term significance are described first as they are fundamental to the path of future development. These stress rejuvenation of the private sector through the structural adjustment of industry, trade, agriculture, and the pattern of energy use. Monetary and fiscal policies are then shown to support the long-term structural adjustment programme, while at the same time serving to redress our urgent balance of payments and budgetary problems. Finally, procedures being established to improve the monitoring and management of the implementation of Government projects and programmes are discussed.

For a decade after independence Kenya experienced rapid industrialization. Import substitution behind increasing barriers to foreign competition assisted in fueling this

primary phase of industrialization. The share of manufacturing in GDP rose from 9.5 percent in 1963 to 13.1 percent by 1983. In turn, the composition of imports gradually shifted away from finished products towards raw materials and intermediate goods for domestic production. Export earnings continued to be concentrated on traditional commodities and were subject to wide swings in volume and value.

A series of shocks to the Kenyan economy during the 1970's gradually brought to public attention the significant decline in growth after 1972 and the fact that there was a growing structural imbalance. Two major oil price increases, the break up of the East African Community, wide swings in foreign exchange earnings, and the rapidly rising cost of imports towards the end of that decade all exacerbated structural weaknesses in the economy. By 1980, a series of structural imbalances came together in a coherent manner. Some of these were international in origin, including: deteriorating terms of trade, dwindling levels of foreign assistance, and increasing interest rate. Other forces were domestic in origin,including: substantial inefficiency in manufacturing, idle plant capacity often caused by shortages of imported inputs and stagnant demand; historically high rates of inflation, money supply growth and low real interest rates; and a large deficit in the government budget.

2.2 The Government's Stated Approach to Addressing Structural Problems

The tight links between trade, industry and balance of payments and financial market policies are demonstrated in the package of GOK policies designed to attack fundamental aspects of structural imbalance. For purposes of organization, the

government's program of structural adjustment in these areas is presented for the period 1980 to the present. This is intended to give comprehensive coverage of the policies and their interrelated nature prior to discussing specific achievements and problems in fulfilling the stated policy agenda. The competitiveness and efficiency of Kenyan producers is a concern both for manufacturing and agriculture.

It is appropriate to measure efficiency in terms of both international price standards and domestic concerns for equitable pricing of products for consumers as well as for producers using domestic inputs. Import substitution during the 1960s and early 1970s, while serving the domestic market and generating jobs, raised costs and decreased the competitiveness of exporters and potential exporters. Industrial protection instruments included: granting of monopoly status, bans on specific imports, import quotas, duty drawbacks, high tariffs, and GOK equity and loan guarantee participation. The reform agenda was intended to help create a climate conducive to increasing efficiency; to restrain new import substitution so that any extension of domestic production would not occur at the expense of potential exporters; and to generate export incentives. Specific policies to implement this agenda fall into seven areas and are described below.

2.2.1 Protection

The GOK formulated a program of gradually rationalizing and reducing protection of domestic producers. The program called for elimination of import duty concessions and quantitative restrictions, with initial substitution of roughly equivalent tariff protection. Tariffs were to be reduced over time. The original Kenyan time table for this called for studies of

heavily protected sectors in 1980 and 1981, followed by a strategy of tariff rationalization and reduction to be implemented during the period 1983 to 1985. In general the objective would be a reasonable level of real effective protection which would be provided to industries, which would be achieved by proper structuring of nominal tariffs on inputs and outputs as well as other taxes and subsidies affecting production.

2.2.2 Import Management

Linked to the program of rationalizing protection, a new form of import administration was to be established as a means of supporting the achievement of structural reform. This new type of import management was intended as a rationalization and simplification of the cumbersome and distorting elements in import administration which has gradually accumulated during the 1970's under several balance of payments crises and the import substitution policies then being pursued.

In summary fashion the new import system instituted can be described as follows:

Schedule 1A

Contents: Raw materials, spares, agricultural inputs, pharmaceuticals, other consumer essentials not produced in Kenya

Treatment: License requests to be freely approved subject to appropriate tariffs and sales taxes and after scrutiny for overstocking

Schedule 1B

Contents: Lesser priority raw materials, spares, balancing and modernizing equipment

Treatment: License requests to be freely approved against annual shilling allotments issued to each approved importer until the annual allotment is exhausted

Schedule 2A
Contents: Items requiring Ministerial approval for importations, including oil, fertilizer, foodstuffs

Treatment: License requests which receive Ministerial approval to be freely licensed

Schedule 2B
Contents: Items produced locally; luxuries; those regulated for health, safety, morality, and defense purposes

Treatment: License requests approved against annual item specific shilling or quantity quotas

Gradual increases in automaticity of treatment for these categories of imports of similar priority were to become a central feature of this policy initiative, as was enhanced public information and understanding of the administrative process. A process of granting allotments to importers for items on Schedules 1 B and 2 A as well as giving priority to exporters in access to import licenses were refinements to be accomplished in the process of implementing this new system. Coupled with reformed administration, active management of the exchange rate was viewed as an essential means of using pricing signals to control imports.

2.2.3 Export Stimulation

The explicit program is the Export Compensation Scheme, which pre-dates the structural adjustment agenda. Changes in the compensation rate applicable to non-traditional exports has been a major part of Kenya's articulated export policy. Administrative reforms to simplify Government approvals facing certain exporters and the concept of manufacture under bond have also become parts of this strategy, as has the strategy of providing preferential access to import licenses for exporters. Strengthening of government promotional activities, including the Kenya External Trade Authority, was likewise supposed to

lend impetus to export performance. As discussed below, another important element in export stimulation has been active management of the foreign exchange rate, which has increased the shilling equivalent of foreign exchange surrendered to the Central Bank.

2.2.4 Exchange Rate Management

Active management of the foreign exchange rate over time has been an important part of the policy initiatives taken. Devaluations raised the cost of imports to domestic users, thus lending some additional protection to domestic producers of competing products (the more so that domestic value added is a high component of production costs). These adjustments in the foreign exchange rate also increased the earnings of exporters surrendering foreign exchange, especially of those with high domestic value added.

2.2.5 Balance of Payments Management

There are two components. One involves control of foreign exchange expenditures through enhanced import administration, higher tariffs, and increased prices caused by exchange rate adjustment. Another focuses on expansion of export earnings via administrative stimulus, compensation for nontraditional items, and enhanced earnings through exchange rate adjustments. The remaining balance of payments gap was then to be covered during the process of structural reform from external finance on concessional terms where possible.

2.2.6 Financial Market Management

Control of the money supply and related changes in the interest rate structure have been stated as key elements in Kenya's strategy for structural change. The impact of carefully controlled increases in money is viewed as a means of

constraining credit to both the private and public sectors A key goal in interest rate management has been achievement of positive real rates to act as curbs on use of credit and as a stimulus to domestic savers.

2.2.7 Management of The General Price Level

Close scrutiny and control of the general price level is a function of numerous domestic policies. While prices in Kenya are directly affected by international conditions beyond a national Government's control, there are means of leverage which can be used to moderate inflationary tendencies. Kenya has set as a goal moderation of domestic prices so as to encourage domestic competitiveness in world markets. Devaluations in an import dependent economy inevitably raise domestic prices. The goal in Kenya has been to hold such price increases to levels less than the rate of devaluation. Wage contract agreements in the public and private sectors contribute to domestic price levels and restraint has been the objective in Kenya. Government deficit spending likewise stimulates aggregate demand and can overheat the economy. Finally, low interest rates tend to stimulate economic activity which can be inflationary. Kenya has sought to manage these elements of its economy so as to moderate inflation and thereby contribute to greater efficiency and growth.

2.3 The IMF and The World Bank Programs

The structural adjustment and conditionality environment that AID entered in 1983 was largely shaped by Kenyan relations with the IMF and the World Bank. The IMF had approved a two-year Standby Agreement in August of 1979, however, no drawings were made initially. In March of 1980 the Bank Board approved SAL I and by September of that year a new, two-year

IMF Standby Agreement was in place. Neither the Bank nor Fund programs fared well. In April 1980, the first Bank review mission of SAL I recommended against release of a second tranche and there were no drawings under the IMF 1980 Standby after credit ceilings were exceeded in mid-1981. The IMF approved a new Standby Agreement in January 1982, but after the GOK failed to stay within the credit ceilings there were no further drawings. The World Bank, in the meantime, approved SAL II.

GOK performance with respect to the Fund and Bank programs started to diverge in 1983. After the first tranche of the 1982 SAL II was released, a third Bank review mission recommended against release of a second tranche (March 1983), as did a fourth review mission three months later. During the same period, however, the IMF found the GOK to be making satisfactory progress in meeting performance targets under the 1982 Standby Agreement. In January 1984 the IMF again determined the GOK was in compliance and credit ceilings were negotiated through mid-year. At the same time, the Bank released the second tranche of SAL II after an understanding that some liberalization would occur in grain marketing. This liberalization did not materialize.

Through its Standby Agreements, the Fund had introduced a series of demand management conditions, that is, measures designed to reduce growth in aggregate demand relative to supply. In SALs I and II, the World Bank introduced measures to affect output growth in the medium and longer term. The AID SAP covered portions of both the Fund's and the Bank's conditions, with the emphasis in 1983 being placed on demand management and the agriculture sector.

During the 1979-1983 period, the IMF concentrated its attention on balance of payments management and on constraining growth in new government or government-guaranteed external debt. There were also discussions (but no conditions) of devaluation, increasing domestic interest rates, imports, exports and debt service.

The World Bank, during the same period, attempted to convince the GOK to shift industrial policy away from one of domestic market protection to a more open, externally oriented approach. This was done essentially by attempting to convince the GOK to follow the Fourth Development Plan and to replace quantitative restrictions on imports with roughly equivalent tariffs.

2.4 SAP Conditions, Related Technical Assistance and Performance

While there was some ESF Program Support prior to June, 1983, significantly conditioned program assistance started with the SAP in mid-1983. The conditions performance and related technical assistance efforts in the trade, industry, balance of payments, and financial market areas are summarized below. See Annex A for a more detailed listing of conditions.

2.4.1 Protection

The terms of the 1983 ESF SAP required the GOK to adjust duties on imports so as to achieve appropriate levels of protection and to promote an overall gradual movement toward a more uniform tariff structure. The June, 1983 budget already contained reductions in tariffs on most items with a duty above 30 percent by an average reduction of 14.7 percent. The 1983 round of tariff cuts can be construed as fulfilling this covenant. A second round of tariff cuts in the June, 1984, budget further reduced levels of protection.

2.4.2 Import Management

Conditions precedent in the 1983 ESF grant required evidence that Import Schedule I had been divided into two parts, with a Part IA which would contain high priority imports for which "unlimited foreign exchange is freely available," including raw materials and spares for agriculture and manufacture of exports. The agreement also required evidence that there would be no restrictions on importation of "appropriate agricultural inputs" except in the case of chemicals, drugs, and fertilizers where lists of acceptable types could be promulgated. The second condition specified that a minimum amount of foreign exchange be provided for fertilizer imports such that it would be at least 120 percent of the estimated 1983-1984 basic fertilizer import requirement.

The GOK presented evidence in the week prior to June 30, 1983, that the composition requirements of both Import Schedules had been met by forwarding to AID a draft copy of the new 1983-84 Schedule I intended for inclusion in the revised Import Schedules. Evidence concerning adequate allocation of foreign exchange for fertilizer imports was presented in a letter dated June 29, 1983, with an attached letter of commitment dated June 27, 1983.

Publication of the actual "Red Book" of Import Schedules in September, 1983, confirmed that the GOK had made the necessary changes in composition of Schedule IA and IB. A letter from the Chief Secretary provided GOK assurance that there would be an adequate allocation of foreign exchange for fertilizer imports.

One covenant in the 1983 program called for the GOK to make reductions in quantitative restrictions on imports "as foreign

exchange reserves permit" and that the GOK make available, on an automatic basis, import licenses for items on schedule IA. No formal notification of fulfillment of this covenant was required. The GOK continued to work at streamlining Import Administration, including assessment of an automatic trigger mechanism based upon foreign exchange reserves to determine the size of Schedule IA; assessment of a system for granting allotments of foreign exchange to importers against which they could import items (up to the value of their allotments for Schedule IB and quotas for Schedule IIB) until the allotment or quota was exhausted; and attempts to make importation under Schedule IA automatic. (See section 2.2.2 for a description of schedules.)

The effort to liberalize imports under Schedule IA during the period June, 1983 through August, 1984. was facilitated by increasing foreign exchange reserves. Scrutiny of items on Schedule IA continued, however. Plans for additional shifting of items onto Schedule IA were made and then announced in the June, 1984 Budget.

The conditions present in the 1984 ESF Grant Amendment set out two requirements. One condition required that the GOK present evidence that by the end of June, 1985, all items placed on Schedule IA would be automatically licensed by the Import/Export Office of the Ministry of Commerce and Industry (after verification of correct licensing information having been supplied), after which the Central Bank would automatically release foreign exchange against such licenses up to the global allocation of foreign exchange established by Government for Schedule IA. A second requirement sought evidence that "a schedule for the implementation of the system of annual allocation for imports listed on Schedule IB will be established by the end of June, 1985."

An implementation letter was sent by AID to the government on October 25, 1984, specifying what would be acceptable as adequate evidence. The GOK responded on February 22, 1985, with an assurance that it was working "towards" automatic treatment of import license requests under Schedule IA after appropriate verification and "subject to the global quota for this Schedule not having been exhausted." Further, it stated that "Government plans that this objective will be met by the end of June, 1985," but cautioned that it was not possible to commit the Minister of Finance and Planning to explicit statements in his budget speech prior to its delivery. The letter also confirmed that" by the end of June, 1985 a Schedule for the implementation of the system for annual allocation for imports listed on Schedule IB will be established and announced."

The statements in the February 22 letter are precise in indicating that the Conditions Precedent had been met. But the statements were effectively promises to attempt action; fulfillment of the promises was to be forthcoming in the Budget Message in June, 1985, and in the actions related to Import Administration during the same month. No covenants were established.

2.4.3 Export Stimulation:

Conditions precedent in the 1983 ESF grant required the GOK to present evidence that since December 30, 1982, "the Government has continued to promote exports and simplify documentation." There was also a covenant that the government "maintain an active exchange rate which will enable exporters to compete effective and profitably." This covenant also obviously applies to exchange rate management.

In fulfillment, the GOK issued a letter on May 30, 1983, which summarized the steps taken to plan for export promotion and simplification documentation. The GOK also provided an "Exporters Guide" which spelled out steps being taken for exporters, including: an increase in the business travel allowance, simplification of import licensing and export procedures, and intention to review the Export Compensation Scheme. The GOK also continued to maintain active management of the exchange rate.

The steps taken to fulfill this rather vague Condition Precedent on export promotion and document simplification met the letter if not the spirit of the condition. In reality little of substance changed for exporters other than a modest increase in the allowance for business travel. Action to maintain active management of the exchange rate was more substantial.

One covenant on exports in the 1983 ESF grant encouraged the GOK to "continue to encourage exports, within the context of a flexible exchange rate system, by pursuing improvements in administrative procedures pertinent to exports and export incentives; and by expediting study of alternative means of export promotion." No formal notification of implementation of this covenant exists or was required. Active management of the exchange rate continued during the period of the grant. The GOK continued to consider and to study various means of stimulating exports, including manufacture under bond and export credit insurance. In the Budget Message of June, 1984, it was announced that "manufacture under bond" would be established. But no date was given for implementation. Steps were taken to pay the incremental export compensation rate for increases in export performance, but it has proven to be exceedingly complex.

Conditions precedent in the 1984 ESF Grant Amendment pertaining to the stimulation of exports required the GOK to present evidence that it "will implement the 'Green channel' documentation procedure for exporters by which exporters can obtain complete documentation for export approvals." This step would be announced by the end of June 1985, plus public announcement indicating where exporters should submit applications for export approvals

In fulfilling the CP, an implementation letter was sent by AID on October 25, 1984 specifying what would be acceptable as adequate evidence. In a response letter of February 22, 1985, the GOK agreed to implement this system as a procedure for exporters by which exporters could obtain complete documentation for approvals. The letter further stated that: (1) "Government shall improve the means for giving advice to exporters on where to submit applications for export approvals"; and (2) that "steps to establish this procedure will be undertaken by the end of June, 1985, and documentary evidence will be provided by the Planning Department of this Ministry."

The wording of the letter of commitment to fulfilling the Conditions Precedent under export stimulation is vague and somewhat confusing. As of May 1985 it remains to be seen whether the GOK will actually implement the intended scheme or announce a timetable for implementation. No covenants were included on export stimulation in the 1984 agreement.

2.4.4 Exchange Rate Management

Neither the 1983 or 1984 ESF grant documents contained conditions precedent pertaining to exchange rate management. The 1984 agreement did include a covenant that the GOK will

"maintain an active exchange rate which will enable exporters to compete effectively and profitably." The GOK did continue to maintain an active management of the exchange rate, thus complying with the covenant.

2.4.5 Financial Market Management

Conditions precedent in the 1983 ESF grant required the GOK to present evidence that it "has taken or has initiated all reasonable steps to meet the following conditions:

a. At June 30, 1983, net domestic credit of the banking system does not exceed 24,794 million Kenya shillings.

b. At June 30, 1983, net bank credit to the Government, net of the deposits of the Cereals and Sugar Finance Corporation with the Treasury, and including any further use of Eurocurrency borrowing after June 30, 1982, will not exceed 7,032 million Kenya shillings.

c. Public and publicly guaranteed external borrowing will be limited during the 18 months ending June 1984: on commercial terms in the maturity range of 1-12 years to US $150 million; and in the maturity range of 1-5 years to US $100 million."

All three condition precedents were met. Compliance was adequate and made possible by the 1983 ESF grant itself which helped the GOK meet the target ratios. No covenants were included in the 1983 grant and the 1984 agreement did not address financial markets.

2.5 General Assessment of Experience With Policy-Based Structural Reform

2.5.1 Overview

Reflection on experience in Kenya with structural reform efforts and associated policy-based donor support during the period 1980 through 1984 yields several general conclusions.

First, Kenya has done a credible job of implementing demand management conditions. The conditions required by the IMF in its Stand-By support have been carried out after several false starts during the early part of this period. Control of the money supply, establishing positive real interest rates, active management of the exchange rate, and control of Government deficit spending and borrowing from the bank and non-bank sectors have all become conditions routinely met under Stand-By Arrangements. It is possible to imagine conditions under which such compliance with demand management elements might break down, but it is true that in the current situation Government has achieved such changes and they have lost much of their earlier controversial nature.

This type of compliance with donor conditionality can largely be termed "decree compliance," meaning that announcement of a new price (be it for money or foreign exchange) or control of borrowing could be implemented by at most a few individuals in the GOK. This does not mean such compliance is necessarily easy in a political sense, but only that it is feasible to implement within the government bureaucratic structure. The one area of IMF conditionality where such a description is not so true is control of the GOK deficit. This has required painful slashing of expenditures within the national budget and efforts to raise tax revenues.

Kenya's ability to achieve "implementation compliance" measures has fallen severely short of the mark set by the GOK itself in the Sessional Papers and other development documents as well as in various Letters of Development Intent and other expressions of commitment to policy-based donor support. These latter type of conditions fall into the category often termed structural adjustment or reform measures. They involve changes, often fundamental, in institutions and policies.

The GOK now argues that the pace of reform in its own policy statements and signed documents was unrealistically rapid and expects donor sympathy and forgiveness; indeed, the GOK verges on being indignant at donor impatience with lack of compliance. Implicit in this position is an expectation that donors should have protected Kenya from overly optimistic promises and/or that donors should be forgiving of any delays which occur. Indeed, the GOK's position implies that policy statements and previous expressions of commitment to reform, even given the substantial slippage in timing of implementation, should continue to be taken as the only necessary expression of good faith and intention necessary to continue donor support for the agenda of reform which now stretches out into the indefinite future.

2.5.2 Conditionality and the AID SAP

An assessment of the conditionality in ESF policy-based support provided to Kenya in the trade and industry area brings forth several additional conclusions. First, some of the conditions were modest and at best required the GOK expressions of intention to move or implement intended policies rather than actual implementation. Lack of adequate performance on such conditions is difficult to attribute to anything but a lack of attention and priority for structural adjustment-based support efforts by donors. What can be termed superficial responses to some other ESF conditions is discouraging for what it says about the seriousness with which Government takes the policy dialogue which is supposed to be an inherent part of ESF Support. In other instances as discussed above Government lacked the basic political commitment to take on hard reform issues according to the previously agreed to time schedules. This is a reality at the present time which must be considered in any future ESF support discussions and agreements.

However, AID conditionality can be faulted for sometimes being vague, too heterogeneous in coverage and priority, and difficult to verify for compliance. These points were raised by the AID Audit of the 1983 ESF Program Grant. Such weaknesses in the formulation of conditionality (more understandable in the crisis atmosphere of the 1983 ESF negotiations) tend to mask and weaken signals AID might have wanted to send to the GOK concerning high priority structural reforms. Indeed, the signals may well have gotten lost in the administrative processing of Letters of Intent by AID to define and signal compliance and return Letters of Compliance from Government attempting to cover the large number and complexity of conditions.

Considering these trends, it is difficult to escape the conclusion that Kenya, despite its stated good intentions towards fundamental structural reform, is not committed at the current time to make the difficult choices and take on special groups with vested interests or strong feelings about current policies and institutions. This does not reduce the sincerity with which the government's stated program of structural reform has been articulated nor does it mean that no progress towards end objectives can be made. But it does imply that donor expectations of progress according to any previously stated time tables may not be fulfilled. This apparently must be taken as a reality within which donors and the GOK may want to continue or renew dialogue about structural change.

The fundamental question facing donors in this situation is whether this current state of conditions in Kenya makes feasible continued general program support for structural reform and whether the concept of conditionality is meaningful. For the GOK, the current situation raises the

question of when progress can proceed in making the difficult and time consuming institutional and policy changes required of any additional meaningful structural reform which is to be undertaken. Donors express concern about the rapidly increasing population and the corresponding explosion of demand for social infrastructure and productive employment. But in the final analysis this is fundamentally a responsibility of Kenya and donors at most can be supportive of change when the environment becomes conducive to making additional progress. In the meantime donors should seek ways to build a foundation for future progress in structural reform, including institutional and policy analysis.

2.6 Specific Areas of Reform

2.6.1 Protection

GOK efforts to reduce excessive levels of protection can be given mixed marks. The reforms in the area of import controls from 1981 to the present clearly make a substantial reduction in the apparent level and operation of quantitative restrictions. There is no doubt, however, that quantitative restrictions will continue to play an important role formally for items on Schedule IIB and informally in the case of at least a few items on the other schedules which are not supposed to have such quantitative restrictions. A systematic process of gradually shifting items off of the quota-based Schedule II B, if it is continued in future years, allows for eventual reduction but not elimination in the role of quantitative restrictions as a form of industrial protection.

Associated changes in tariffs have likewise started the process of rationalizing and gradually reducing tariff protection so that greater levels of competition would exist in

the Kenyan economy. In the June, 1983, budget there was an average 15 percent reduction in tariffs above 30 percent The June, 1984, budget announced an average 14 percent reduction in tariffs over 25 percent, although certain highly protected items such as textiles were exempted. In both 1983 and 1984 sales tax rates were raised on items where tariffs were reduced so that the end-price to consumers would remain approximately the same while domestic producers would be faced with slightly lower CIF prices on competing imports.

According to Kenya's strategy for structural adjustment, further reductions in tariffs, until they approach a uniform rate of approximately 30 percent, would occur in the future. However, the GOK has consistently insisted on in-depth industry studies and a transition strategy as a precursor to final changes in protection.

There is a continuing inconsistency and tension between operation of the import administration system and policies and levels of protection. As long as the operation of the import system is infused with protectionist sentiment, manifested in the opinion that no scarce foreign exchange should be wasted importing products made locally, then the nominal levels of tariff protection (as moderately reduced by the tariff cuts of 1983 and 1984) are not the determining factor in import decisions. The pricing signals of tariffs and foreign exchange rates are then not allowed to operate unhindered in allocating foreign exchange to imports. This obviously weakens the impact of reductions in nominal tariffs on items competing with local manufacturers; it does help local producers, however, by lowering the costs of their imported inputs.

Given the general tariff reductions announced in the 1983 and 1984 budgets, it is still true that levels of protection

are high although estimates of nominal as well as effective levels of protection are not readily available. Second, a few more years of general tariff cuts will bring levels of protection down so that they begin to harm inefficient sectors and cause substantial problems of transitional adjustment. In fact, some of the inefficient sectors, especially textiles, have already been exempted from these general tariff cuts, presumably until industry studies and analysis chart a feasible path of reform.

Progress on industry studies has been painfully slow but is now underway with an initial study of efficiency and comparative advantage. A consultant is organizing a study of 122 sample firms in 30, four-digit International Standard Industrial Classification sectors, with analysis including import liability, capacity utilization, export potential, and operating efficiency. The exercise is supposed to calculate effective rates of protection and train Kenyan staff so that similar analysis can be done locally in the future. There are GOK plans to follow this initial study, due for completion in September, 1985, with a more in-depth second phase which would tackle seven or eight problem sectors identified in the first study. This places any detailed policy changes concerning protection for these problem sectors in 1988 at the earliest. It may be that the GOK is ready to proceed with orderly reductions in protection on the basis of preliminary data and recommendations from these studies, but the power of vested interests is likely to make reduction of protection difficult, if not impossible.

As disappointing as Kenya's progress on this issue has been to donors and to some Kenyans, the scope for further action over the next three to five years is limited. Now that the

initiative exists, it is important to provide assistance in furthering the necessary studies so that the policy options and dimensions of economic and political costs and benefits associated with a serious effort to rationalize and reduce protection are clear to Government; only then will policy formulation and implementation likely proceed.

2.6.2 Import Management

Kenya should receive high marks for making progress towards rationalizing the regime of import administration. Despite disappointments at certain parts of the system, it is clear that there is a much improved administrative system, that information is now more readily available to the public, and that license requests are processed and decisions announced on a more regular basis.

The fact that there is continued scrutiny of all import license applications and selective rejection is evident from discussions with importers. In general terms the proportion by value of import licenses being approved in early 1985 appears to be the following:

	Percentage
Raw materials - schedule IA	95
Raw materials - other schedules	50
Industrial spares - Schedule IA	70
Industrial spares - other schedules	40
Motor vehicle spares	50
Drugs & hospital equipment	95
Agricultural Inputs & Implements	95
Machinery	85
Books	70
Appeals (of prior license rejections)	40
Foreign Exchange required	90
Miscellaneous, especially Schedule IIB	10

One reason for there being continuing elements of administrative control and use of quantitative restrictions is

the fact that the import administration system is a vital part of the protective regime as discussed above. Nominal tariffs are in many cases made inoperative in controlling imports and the primary rationing device remains application of import restrictions. This will likely continue until and unless basic rationalization of the protective regime is designed and successfully implemented. In the meantime, it is unrealistic to expect that the GOK will totally dismantle administrative controls in the area of import administration. The best that probably can be achieved is a gradual reduction in administrative intervention and a regularization of procedures where such administrative controls continue.

In periods of scarce foreign exchange the first reaction of import administration and foreign exchange budgeting is to severely restrict imports. While potentially legitimate as a means of reacting to changing conditions, Kenya's ability to make an orderly reduction in non-essential imports while maintaining the flow of critical raw materials, intermediates, and spares is limited at best. Efforts to improve the administrative capabilities of the system to make orderly retrenchment in time of foreign exchange shortageêes could pay large returns in minimizing the damage done to the economy as imports become less readily available.

2.6.3 Export Stimulation

One of the disappointing aspects of Kenya's performance in fulfilling its own agenda of structural reform is continuing inaction in the area of export stimulation. The little which has been done has merely made some technical changes in level and operation of the Export Compensation Scheme, but even those changes have been largely neutralized by extremely slow processing of claims and distrust of exporters' intentions at

every stage by the GOK. Announcements of additional steps to assist exporters, be they manufacturing under bond, a green channel of administrative approval, or export credit, have been delayed or found infeasible.

Perhaps because the conditionality of various donors was so comprehensive and because exports never ranked high on the lists donors maintained of critical structural change, progress and even vision of where Kenya might go in stimulating exports has been severely lacking.

2.6.4 Exchange Rate Management

Kenya has made adequate progress in managing its exchange rate. In consultation with the IMF, the value of the Kenya shilling relative to the SDR depreciated by nearly 38 percent from February, 1981, to the present. This returns the real effective exchange rate to the level prevailing in the middle 1970's when there was a strong balance of payments situation and freer importation.

Foreign exchange reserves have also been returned to an adequate level, having gone through the following trend:

1980	10 weeks of imports	1983	15 weeks of imports
1981	6 weeks of imports	1984	12 weeks of imports
1982	7 weeks of imports		

This level of reserves is likely to drop some as payments for any outstanding food imports not financed by donor assistance reach the payment stage. If Kenya's relationship with the IMF continues in an orderly manner as in the past two years, this will help assure continued progress in actively managing the exchange rate.

2.6.5 Balance of Payments Management[1]

Again with consultation from the IMF, Kenya has instituted an acceptable program of managing the balance of payments. It would appear that debt servicing obligations are being watched closely and resort to commercial term borrowing is being avoided in most instances. The import system is one critical element in this management approach, along with management of invisibles by the Central Bank. The short and medium term outlooks appear viable; the longer term view is clouded by lack of progress in stimulating additional export earnings, especially from non-traditional exports, and the limits to net resource flows as previous external borrowing must be serviced.

2.6.6 Financial Market Management[1]

Government has done an adequate job of managing the financial markets, again under the close scrutiny of the IMF. Interest rates have moved from negative to positive levels in real terms as shown below:

Table 2.1. Commercial Bank Loans and Advances

	Commercial Bank 9-12 Month Time Deposit Rates%		Commercial Bank Loans and Advances	
Year	Nominal %	Real %	Nominal %	Real %
1979	5.63	-5.9	10.0 (min)	-2.0
1980	5.63	-6.4	10.0 (min)	-2.5
1981	6.35	-11.4	11.0 (min)	-7.9
1982	12.25	-4.4	14.0 (max)	-2.9
1983	13.79	3.2	16.0 (max)	5.2

[1]Not an explicit part of the AID SAP.

Government borrowing and the health of financial intermediaries also received attention. While problems remain, there are programs to address some of them and an apparent concern by Government that a sound financial system be a fundamental part of the management of the economy.

2.6.7 Management of the General Price Level[1]

Inflation has been brought under control as part of the structural adjustment agenda of Government. Data on yearly increases in prices reflect this.

Table 2.2. Yearly Increases in Prices (in percent)

Year	GDP Deflator	Composite Cost of Living
1979	6.6	9.4
1980	10.6	12.0
1981	10.8	20.2
1982	9.9	14.4
1983	7.9	10.1
1984	9.0(est)	9.7(est)

Pressure from the IMF on Government deficit spending has made a significant contribution to reducing inflationary pressures. The progress on the deficit is impressive:

Table 2.3. Government Budget Deficit As Percent of GDP at Market Prices

Year	Level
1978/79	7.4
1979/80	5.7
1980/81	9.5
1981/82	6.6
1982/83	3.1
1983/84	4.6 (est)

[1]Not an explicit part of the AID SAP.

However, there were significant distortions in GOK expenditure patterns and traditional practices of finance in order to meet the IMF conditions. Borrowing from the financial intermediaries as well as limits on wage increases helped hold down prices All of these steps helped provide reasonable levels of credit to the private sector. In summary, despite widespread dissatisfaction with the operation of the price controls and the squeeze put on the economy by actions to control inflation, the GOK did a credible job of controlling general increases in wages and prices.

2.7 Future Approaches to ESF Policy-Based Support, Conditionality, and Related Technical Assistance

2.7.1 General Overview

The application of conditionality in past ESF Grant activities as well as by multilateral donors has been too disjointed and often counterproductive. Granted the desire, even requirement, on the part of donors to move policy dialogue along into concrete policy implementation which will provide for gradual structural changes in the Kenyan economy. But much more thought needs to go into a multi-year agenda of focused structural reforms which are viewed by a donor (or a group of donors engaged in policy-based support) as essential to achieving fundamental structural reform and feasible for implementation by the GOK. Considerable friction and some animosity has developed over structural adjustment-based conditionality which in retrospect was not feasible for implementation. Despite GOK public and private pronouncements of policy initiatives and directions intended for implementation, one apparent responsibility of donors engaged in policy-based support is to distinguish the possible from the larger set of desirable changes, the nearer term reforms from

vague longer term goals, the areas where policy implementation can be verifiable in a satisfactory manner from qualitative changes which would be ripe for misinterpretation and contention.

In the areas of trade, industrialization, balance of payments, and financial markets (which it has been argued above should be treated in tandem) there is a strong case for a sharper and narrower focus of ESF-related structural concern and possible conditionality in any future program-support initiatives. In part it must be admitted that this can be argued because Kenya has made progress on demand management issues which traditionally are overseen by the IMF through its Stand-By Agreements. It is possible that Kenya will maintain a commitment to fulfilling such IMF-like conditions for a number of years into the future, both because there will likely be a continuing relationship with the IMF (although this may switch to an Extended Fund Facility sometime in the next few years) and because it would appear that Kenya has now accepted the basic tenants of demand management as a routine part of managing its economy. Apart from dramatic emergencies and/or substantial changes in political commitment, Kenya will likely pursue responsible demand management without the presence of AID conditionality.

It is taken as given that prudent demand management is a necessary but not sufficient condition for pursuing structural reform of trade and industry (as well as other types of reform) in Kenya. If we assume this necessary condition as likely being fulfilled (which is the case in this assessment), then continuing changes in relative prices can have a substantial contribution to make in restructuring trade and industry. In fact, some argue with modest conviction that such shifting

relative prices are the only changes needed to bring about structural reform. This can be rejected as either requiring too much time if left to work on the structure of the economy alone, and/or because such changes alone are insufficient. Far better to reinforce the necessary demand management changes with sharply focused but feasible policy-based support conditions which give the economy a push in the right direction at a speed which is uncomfortably rapid but achievable in Kenya.

Within the constraints discussed above which narrow feasible action, future ESF policy-based support should in general seek to narrow the areas of structural concern, sharpen any related terms or conditions, and selectively use supporting technical assistance. The possibility of the GOK formulating a Letter of Development Intent in consultation with AID should be explored as a means of improving the policy dialogue and increasing the commitment of the GOK to the structural reform intended through such letters and associated grant support. Likewise the idea of task forces between AID and Government should be explored as a means of formulating policy options and exploring problems on a continuing basis. Such new approaches to policy dialogue and formulation of conditionality probably cannot be included in the formulation of a 1985 ESF program, but should be explored now for use in future years.

With the objective of sketching some possible areas of structural concern and related types of conditionality for a 1985 ESF Program which fit the criteria set above in the trade and industry area, the following specific structural concerns and conditions are recommended as desirable and achievable in future ESF grant agreements. Here no distinction is made between conditions which might be condition precedents versus those which might be covenants in such Grant Agreements; such

formulation of specific conditionality, if used in future grants, must be left to a later time when initial decisions have been made about the shape of funding levels, mix, and thrust of policy reform to be pursued.

2.7.2 Specific Areas of Possible Dialogue and Action

In keeping with the sub-divisions of the trade, industry, balance of payments and financial markets areas of the Kenyan economy used throughout this discussion, recommended structural concerns and related technical assistance have been categorized below under a specific heading. However, it is important to understand that the structural changes being pursued through these recommendations cut across these sub-divisions and indeed of the entire economy. Only in a limited sense, then, can they be viewed as primarily pursuing a single stated objective such as improved import management or export stimulation. The effects of changes spread to other areas of structural concern and reinforce each other.

Areas of possible dialogue and action concerning protection are:

1. The GOK assess the initial phase of the industry efficiency and protection study now underway and consider formulation of plans for a second follow-on phase.

2. The GOK establish an "Assistance in Production and Marketing Efficiency Project" designed to provide firms (on a cost-sharing basis) with expert consulting assistance on product and process design, quality assurance, and market penetration strategies. The intended users would be both firms in problem sectors facing restructuring (as identified by the first and follow on efficiency and protection studies) and firms with export potential.

3. GOK maintenance of progress towards rationalization of the tariff structure.

The key to structural reform of industry in Kenya centers on protection. A detailed and sensible agenda of reforms is essential; this spans both the trade regime and industry sectors. After interminable delays in mounting serious industry studies, Kenya has finally started analysis of industry efficiency and protection with technical assistance from the U.S.

The above three areas of possible dialogue are tightly linked so that continued rationalization of tariffs is supported by increasing information on industry sectors of promise and problems. The proposed Assistance in Production and Marketing Efficiency Project is intended to provide readily available assistance to firms in Kenya put in difficulty by changing tariff levels and resulting improved competitive conditions. It will be counterproductive to identify sectors of problem and promise through industry studies if no transition strategy exists to move inefficient firms towards sustainable and efficient performance and firms with export potential towards actual performance.

It is important to consider why firms which are highly inefficient or are neglecting real export possibilities apparently fail to maximize profits or minimize losses. It would appear that in Kenya, behind traditional high protective barriers, entrepreneurial effort is too often distracted into administrative or political efforts to gain advantage?rather than into traditional managerial actions to increase profits in existing plants and industries. If so, then as protection is reduced such managers will be faced with a substantial job of improved economic performance. From the GOK's perspective, such a transition has social implications for employment and capital usage which go beyond the benefits earned or foregone by individual entrepreneurs.

A second area for possible dialogue and action concerns technical assistance and support for the second phase of the government's industry studies. Similarly AID may want to consider support for the Assistance in Production and Marketing Efficiency Project. Possible actions are to do initial design and scope of work preparation and/or to initiate the project.

Resources to complete the second phase of the industry studies are critical to maintaining the recently gained momentum on industry restructuring and associated reform of protection. This is one of the most critical areas of structural reform in Kenya. AID should give a high priority to this effort.

Linked closely with the industry studies are design and implementation of a mechanism for providing firms with expert consulting assistance in making the transition to new levels of protection and competition. Without such a project to assist firms who will bear the major impacts of realignment of protection in Kenya, fear of change and inability to make the necessary transition will create extreme levels of opposition to reform. The GOK may anticipate such potential opposition and wish to provide practical and readily available means of assisting firms in the transition phase to increased efficiency.

Import management is a third area of possible dialogue and action. Items to be considered are the following:

a. Government maintenance of progress in shifting items onto Import Schedule IA where license requests are to be processed automatically by both the Import/Export Office of the Ministry of Commerce and Industry and by the Central Bank, except in cases of overstocking.

b. GOK provision of a plan for strengthening import administration through improved information management, which would link Import/Export Office, Central Bank, Customs, and port aspects of import processing.
c. Government implementation of the system of granting allotments to importers for items on Schedule IB and IIB.
d. Government implementation of a system for providing preference to exporters in the granting of import licenses.

Measured against the standard of import administration in 1980, considerable progress has been made in Kenya in streamlining the process of import license approvals and foreign exchange releases. There is no doubt that elements of administrative intervention remain and will for a number of years in the future. Operation of even the supposedly automatic Schedule IA does not fit the stated objectives of the government; scrutiny for overstocking can and does lapse over into more blatant forms of administrative protection for local stockists and producers. However, it must be realized that the import system has gone through severe shocks during the past decade. It will take several years of normal operation and maintenance of adequate levels of foreign exchange reserves before the hoarding instincts of importers and the administrative interventionist tendencies of the bureaucracy are likely to give way gradually to more automatic processes. Certainly maintenance of appropriate exchange rates and real interest rates will help to tone down tendencies towards hoarding. Adequate enforcement of customs regulations will also be required so that foreign exchange goes to intended types of imports.

The above possible actions conform to the GOK's stated objectives in reform of import administration. Further, the

reforms are feasible to implement, although they will stretch the GOK's capacity to manage imports. The reforms also press against the outer limits of structural change which can be achieved in Kenya presently; there are segments opposed to even these types of modest reform and improved efficiency, tending to be more comfortable with traditional types of intense administrative control and intervention at all stages of importation.

These recommended actions are considered, therefore, as probably the most that can be achieved over the next few years. If Kenya does achieve such reforms, then the stage will likely be set for more fundamental change in the form of administrative retreat from direct control of imports.

It is also worthwhile to consider provision of technical assistance to provide support for carrying out government plans to improve information management in import administration. Possible actions are the following:

a. initial design of a project to achieve government intentions;
b. support for initial implementation of the resulting project, including necessary information processing equipment, training, and advisors.

There is a dilemma involved in recommending U.S. support for administrative reforms of the import system. It is clear that the strict automaticity which has been part of past conditionality and of Kenya's stated intentions for reforming import administration will not be fully achieved in the next few years. On the other hand, considerable progress has been made in removing the worst abuses of a system which in 1980 was an administrative nightmare. Momentum in continuing gradual

progress towards regularizing and streamlining import administration is essential; it will likely not be achieved without some technical assistance since the management problems are becoming increasingly sophisticated.

It is recommended that the likely pattern and timing of additional reform the GOK plans to introduce in import administration over the next few years is acceptable and supportive of the types of structural reform necessary. The import system needs to mature and become as efficient as possible so as to reinforce the types of industrial restructuring which will also progess over this time period. To cut the import system off from improved efficiencies which could be achieved with the help of technical assistance might in the end become a reason why industrial reform cannot proceed apace.

Areas of possible dialogue and action concerning export stimulation are:

a. Government implementation of manufacturing under bond.
b. Government production and publication of a positive list of items eligible for export compensation.
c. Government assessment of the concept of an export credit guarantee scheme run by the private banking/insurance sector and self-financing through insurance premiums paid by Kenyan exporters.
d. GOK finalization of the "green channel" treatment of administrative approvals of exports.

There is a severe lack of momentum in Kenya over aggressive stimulation of export activity. Administrative structure is one problem, with responsibility splintered among a number of agencies, each of which does not want to give up power and

involvement. Lack of a viable strategy for how to effectively stimulate exports in the Kenyan situation is another constraint.

It is true that continuing active management of the exchange rate and gradual rationalizationêon and lowering of the tariff structure on imports both will provide some stimulation to exporters. This will mostly be confined to those producers with previous export experience and to those potential exporters in sectors with clear and strong levels of efficiency and competitiveness in world markets.

These problems have existed for some time and will likely not be solved soon. In the meantime, there are some incremental steps which can be taken, thus the actions recommended above. It is important to push for feasible reforms and strengthening of the export sector in Kenya so that appropriate help for exporters will be available.

The Assistance in Production and Marketing Efficiency Project is intended to provide direct assistance to firms capable of exporting but requiring expert assistance. The combination of the actions listed above plus a source of expert consulting assistance as relative prices and administrative procedures become increasingly favorable will move in the direction of strengthening an export dimension to the Kenyan economy.

Other possible technical assistance measures are:

a. Provide support for a feasibility study by government of a private sector, premium-based export credit guarantee scheme.
b. Provide support to the Investment Advisory Promotion Center to strengthen its capacity for advising Government on

policy issues (including reform of an investment code) and providing services to investors interested in Kenyan projects.

Most of the steps necessary to strengthen export promotion must be taken by the GOK. Those actions listed above have, for the most part, been under study and design by the GOK for far too long. Further study is not necessary, resolute action is required.

The concept of a private export credit guarantee scheme is a new twist on a proposal which has been studied in Kenya for years. The previous concepts have involved government participation and the conclusion drawn was that such a public scheme would require public funds in an era of severe limits and budget constraint. It is worthwhile to explore another avenue towards a desirable objective: provision of credit guarantee for exporters.

The Investment Advisory Promotion Center (IAPC) can have an important role to play in expanding investment, foreign and domestic. As a new entity it requires capacity building assistance if it is to provide solid and timely advice to the GOK and service to potential investors.

If AID wants to be involved in balance of payments policy, the following measures are suggested:

a. Establish a trade policy research unit or center with the purpose being to strengthen analysis of trade related assistance.
b. Provide support for a trade policy research center support could consist of actions such as initial design of the project; or support for creation and initial operation of

the Centre, including training of Kenyans, equipment, consultant studies, and advisors.

Fragmentation of responsibility for trade policy and implementation presents a problem when it comes to research and analysis. The GOK can make the necessary administrative decisions, but a mechanism for exploring alternatives and assessing Kenya's current and future trade situation is not being adequately pursued. A trade research capability function would address this problem.

The proposed research function reinforces the efficiency and protection studies being pursued for industry. Trade is a critical area of economic management. Capacity building in this area is an important means of improving capacity to design and implement structural reforms in the next few years.

3. AGRICULTURAL POLICY

3.1 Description of Conditions and Nominal Performance

Although AID is concerned about all Kenyan policies affecting agriculture, and about Kenyan agricultural performance in particular, the following discussion concentrates on the two major areas of agriculture in which the AID structural adjustment program is concentrated: maize marketing and the fertilizer distribution system.

In the first decade after independence, Kenya experienced vigorous agricultural growth: farm output grew by 6.2 percent a year between 1965 and 1973. In the 1970s and early 1980s, however, growth in agricultural output slowed markedly--to 3.4 percent per annum (1973-83): a rate less than that of the population growth growth rate. Most of the slowdown took place in domestic crop production.

There were many reasons for the decline in agricultrual growth, but most observers agreed that poor policies were an important cause. The World Bank view of what needed to be done in agriculture was reflected in the conditions of its two SAL programs. These programs focused on raising producer prices, reforming grain marketing (a greater role for private traders and the restriction of the NCPB role to that of a buyer and seller of last resort), improving project accounting and budgeting within the Ministry of Agriculture and Livestock Development (MOALD), and land reform issues. AID's structural adjustment program generally agreed with the Bank's analysis and prescription, the only overlap on specific conditions being in grain marketing.

3.1.1 Liberalization of Fertilizer Distrubution

The conditions in the 1983 AID Program Grant that concern agriculture directly all pertain to fertilizer with one exception. The 1983 and 1984 programs are discussed together because implementation of the conditions from the two programs merge over the two-year time period.

Conditions Precedent from the 1983 Program Grant pertaining to fertilizer are as follows:

A. That the Fertilizer Advisory Committee will be established and that it shall advise and guide the government and the private sector on:

1. development of estimates of annual fertilizer requirements, both types and quantities, and periodic revision of those estimates following analysis of market trends;

2. the system for establishing prices of fertilizers;

3. the amount of foreign exchange required to finance fertilizer imports;

4. the identification of private sector firms and organizations that may be authorized to import and distribute fertilizer;

B. Imports by the government, whether obtained commercially or from a donor, will be sold by the government to any licensed fertilizer dealer for distribution through channels available to that dealer.

C. The 1983 agreement also asks that there be no restriction on the import of or availability of foreign exchange for appropriate agricultural inputs, and that for fertilizers there be established a minimum amount of foreign exchange (minimum to be 120 percent of foreign exchange required for basic fertilizer requirements).

Covenants from the 1983 Program Grant pertaining to fertilizer are as follows:

A. Establish a Monopolies and Prices Commission which will review commercial practices, impose sanctions for practice in restraint of fair trade and recommend reduction of price controls on specified items for which there is sufficient

internal and external competition in the Kenya market and will give top priority to consideration of the prices of fertilizers.

B. Review with USAID within six months, and again within one year the effectiveness of the Fertilizer Advisory Committee that will be established in June 1983.

Conditions precedent from the 1984 Commodity Import Program (an ESF-funded $13 million loan for fertilizer and shipping are as follows:

A. Evidence of the establishment of a Fertilizer Committee to implement the private sector fertilizer distribution policy;

B. Evidence of the publication of current fertilizer stock levels and donor fertilizer financing intentions;

C. Evidence of publication of an up-to-date compilation of commercial fertilizer imports and anticipated donor financing.

Covenants from the 1984 Commodity Import Program are as follows:

A. The Fertilizer Committee will announce wholesale and retail prices for fertilizer by November 1 of each year beginning in 1984.

B. The GOK will publish fertilizer stock levels and known donor fertilizer financing intentions by June 1 of each year beginning in 1985.

C. The GOK will distribute a list of commercial fertilizer import applications compiled by the Fertilizer Committee by July 15 each year beginning in 1985.

D. The Fertilizer Committee will develop a fertilizer import plan specifying types, quantities and timing of fertilizer imports and anticipated donor financing. The plan will be published by July 30 each year beginning in 1985.

E. The GOK will complete a review and revision, as appropriate, of the current pricing structure for fertilizer in order to provide adequate compensation for and promote a wide distribution of fertilizer. The objectives of the review and revision will be to:

1. Establish wholesale and retail fertilizer prices on a timely basis so that farmers, distributors and importers can plan ahead;

2. Implement a standardized price structure for fertilizer of the same type that arrives at different times. For example, a firm price for DAP should be established for a 6 month period, based on the international market;

3. Establish price levels, both wholesale and retail, for various clients, i.e., authorized importers, large distributors, small distributors, village stockists, 1000 ton users, and small users.

F. The GOK will establish a policy authorizing application of a surcharge on fertilizer sold in properly marked packages of 25 Kg. or less.

3.1.2 Nominal Performance

In response to the AID condition that a Fertilizer Committee be established, the GOK asked AID to consider the existing Fertilizer Advisory Committee (FAC) in the MOALD to perform the functions of the Fertilizer Committee as proposed by AID. AID accepted this proposal with the understanding that the FAC and the Commodity-Aid Allocation and Monitoring Committee (CAMC) would be strengthened by the establishment of the Fertilizer Coordination Committee (FCC) which would have full-time secretariat support.

The FAC was formed in September 1983. The work to meet the requirements that call for the FAC to provide prices and estimates of fertilizer requirements and types, as well as related foreign exchange requirements, has actually been done by the Ministry of Finance and Planning (MOFP, also Treasury) and the MOLAD in consultation with the Office of the President. The FAC reviews and approves the findings of the two ministries.

Estimates were made and passed through the FAC in late 1983-early 1984 but they were too late to serve the intended planning purpose and the 270,000-ton estimate that was received exceeded the previous maximum fertilizer import level by

110,000 tons. In the 1983 program, AID financed the import of 14,000 tons of fertilizer. Seven thousand tons went to the Kenya Farmers Association (KFA) and 7,000 tons were allocated among five private firms.

By the 1984-85 season, 15 firms were on the approved list permitting them to apply for a fertilizer allocation (firms are placed on the eligible list if they have a record of having imported or distributed fertilizer). When the FAC announced it would take allocation applications for 50,000 tons of AID-funded fertilizer 29 firms applied, including the 15 firms on the original eligible list. In early 1985 all 29 firms were given allocations. A few firms that received allocations had no history of having been in the fertilizer business and, upon receiving an allocation, immediately took steps to sell their allocations to firms in the fertilizer distribution business. Some of these firms are reported to have had a special relationship with government, for exapmle, a government official may be a part owner. So far this kind of activity has not apparently harmed the program, but the practice illustrates a type of difficulty that occurs and requires close monitoring.

By late April 1985, 13 firms had acquired bank guarantees for a total of 13,000 tons of the AID 50,000-ton program. The Kenya Grain Growers Cooperative Union (KGGCU) received an allocation for 6,500 tons. The AID Mission monitors the working of the bank guarantee process through Price Waterhouse. The entire 50,000 tons was allocated but because only 13 of the 29 firms could obtain bank guarantees, 37,000 tons remain. These are to be reallocated to firms which can obtain bank guarantees. There is no assurance that sufficient bank financing can be obtained to allow for purchase of the

entire 50,000-ton program. Typically, firms must already have sale contracts or adequate collateral to obtain a bank guarantee.

In response to covenant E of the 1984 CIP, it was agreed that a study of fertilizer pricing would be undertaken. This study is to be done by Michael Schluter, an economist with extensive experience in Kenya. (For example see: Constraints on Kenya's Food and Beverage Exports, IFPRI, Research Report No. 4, April, 1984). It is anticipated that Schluter will start the study in mid-1985.

3.2 Liberalization of Maize Marketing and Pricing Policies

3.2.1 Description of Conditions

Conditions precedent from the 1983 Program Grant are as follows:

Evidence that the Government is taking steps to develop an integrated food security policy, reduce the drains on public finance by the National Cereals and Produce Board (NCPB) and study the management and organization of grain marketing.

Conditions precedent from the 1984 Program Grant are as follows:

A. Submit a report to AID specifying that the problem of timely cash payments by parastatal and cooperative bodies to producers for the principal food crops is resolved. The financial evidence should include statements of accounts for the NCPB and the KFA through December 1984. The report to AID was also to state that Government has or will publicly announce that cash payment to producers is to be the established procedure.

B. Evidence that the GOK shall increase controlled procurement prices of grain in accordance with its current policy for analyzing increases.

C. Evidence in the form of a letter stating that Government shall reach agreement with the NCPB and the MOALD that when the estimated annual output for maize has returned to 90 percent of

a 10-year production trend, private persons, or private entities now owned or controlled by Government, may purchase at least one million bags of maize from producers for sale in the domestic market. With normal long rains in 1985, it is expected that these private purchases will take place during the long rain maize harvest in late 1985. The letter will include a specific quantity of maize production which represents 90 percent of the 10-year production trend.

3.2.2 Nominal Performance

In response to the integrated food policy element, a scope of work was prepared for a study to examine integration of food issues by the GOK as a basis for reform. A food policy options paper was also prepared by the MOALD and circulated in the Treasury.

There is no clear evidence that the NCPB was successful in reducing its deficits. Demands on the NCPB budget increased in 1984-85 as the NCPB increased expenditures to cover transportation and distribution costs of food during the drought. The response to the third element of the condition precedent in the 1983 Program Grant was the preparation of the scope of work for the Booker-Githongo study of maize marketing. The Booker-Githongo Grain Marketing Study (GMS) study was completed in October 1983. The draft has not yet been released by the GOK, although a USAID memorandum states that the GMS was accepted by the Government as the basis for reform.[1]

Responses to all three conditions in the 1984 Program Agreement were provided in official correspondence from the Permanent Secretary of the MOFP. Concerning the first condition, the Permanent Secretary indicated the payment

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[1]Dwight Smith, Agricultural Office, USAID, Nairobi. undated paper "Kenyan Grain Marketing Reform."

problem had been solved and that it has always been established principle that farmers be paid on delivery. The second condition was met when the 1984 Price Review was conducted and prices were increased along established guidelines. It was announced in newspapers on January 31, 1985 that the NCPB purchase price for maize would be increased by 12 percent to 175 shs. per 80 kg.

The Kenyan Treasury response to the condition that private dealers be permitted to purchase one million bags of maize (90,000 tons) was that the GOK would allow this when the situation returns to normal as defined by maize production adequate to rebuild NCPB stocks "to their pre-drought levels, which conform to those of the Kenya Government's Food Strategy Paper." The Permanent Secretary felt that it was unlikely that sufficient surpluses would be forthcoming in 1985.[1]

The outcome of the 90,000-ton condition will not be known until late 1985 when purchases from the long rain harvest will take place. Whereas the Treasury stated that it was unlikely that private traders will be allowed to buy at least 90,000 tons of maize, there is a possibility the Treasury may be forced to reverse its position if a large maize surplus is produced. Some expert observers predict that a near-record maize harvest may be produced in 1985 because of the combination of favorable weather (as of early May) and the fact that Kenyan farmers planted larger than normal areas in maize. It is not certain that a bumper maize crop will lead to an excessive level of maize for sale because the amount marketed

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[1]Letter addressed to USAID Director Charles Gladson, dated February 22, 1985 from H. M. Mule, Permanent secretary of the Ministry of Finance and Planning

can be influenced by other important variables such as farmers restocking their inventories. Nevertheless, in the past, large harvests have forced the NCPB to allow private traders into the market when the NCPB could no longer pay for or store additional maize. Thus, the 90,000-ton condition may be met by default; if it is, it should not be interpreted as having particular policy significance.

3.3 Assessment of the Structural Adjustment Program in Agriculture

3.3.1 Significance and Realism of Conditions: Fertilizer

Some of the conditions for agriculture attempt to improve the government mechanism for administration of fertilizer import planning and the functioning of the administered pricing system. A key condition intended to effect structural change is that government fertilizer imports, whether commercially or donor financed, will be sold to any licensed fertilizer dealer for distribution by that dealer. Two conditions pertain to price: one calls for the introduction of a limited degree of flexibility in the (fixed) official price for the numeraire unit of 50 kg. to allow for higher costs associated with bags of less than 50 kg. A second price condition calls for fixing the price paid by importers for six-month periods to enable them to know what margins will be between the import price and the official maximum price.

With respect to maize marketing, two of the three relevant conditions ask the GOK to meet its commitments within the existing system of administered controls and one condition calls for a modification to allow an increase in commercial private maize trade. Only the last condition seeks to change policy and it is relatively modest.

Fertilizer is an extremely important part of the Kenyan economy. The Kenyan economy is agrarian and Kenya imports all of its fertilizer. There have been major, chronic failures in importing sufficient quantities of fertilizer of the right type at the proper time. The characteristics of Kenyan agriculture are such that additional fertilizer tends to be highly effective in increasing output: crudely, one ton of high protein fertilizer increases output by about eight tons. Thus the AID effort to increase the supply of fertilizer and to increase farmers' access to the commodity is strategically significant in the overall effort to increase agricultural output. Furthermore, the conditions pertaining to fertilizer in the 1983 and 1984 AID programs are highly relevant given the specific problems in the Kenyan fertilizer import and distribution system.

Improvement in the functioning of the fertilizer import regime is a significant exercise. The only question is, was the actual approach chosen the best possible one? Improvement of the existing system is a second-best solution relative to that of freeing the system of government control altogether, but there is little reason to believe that the first choice was available. However desirable, the GOK is not likely to disassemble an entire control structure in one stroke. An effort to improve the existing system was a compromise. It turned out to be a tradeoff that yielded useful results.

The implied objective, however--to increase the degree of coordination in fertilizer importing--was worthwhile, and the conditions served to encourage coordination and to initiate a deliberate effort to grapple with the inadequacies of an administered fertilizer supply system. Perhaps the most significant aspect of the FAC is that it provides a direct line of communication between the private sector and the Ministries.

For example, in 1984 when the price of fertilizer was set at 2,800 shs. per ton, the business members of the FAC made the case that the price did not allow an adequate distribution margin. The price was subsequently raised to 3,000 shs. per ton.

Typically, 40 to 50 percent of total fertilizer imports are covered by donor assistance with the remainder imported on commercial terms. Thus the move to have private firms compete in the distribution of donor-financed fertilizer imports potentially doubles the size of firms' distribution business. An important feature of the AID program is that it creates a strong vested interest within the Treasury to adopt and retain the scheme. Fertilizer importers, both private and quasi government, must have a bank guarantee that payment will be made. Thus the Treasury is assured that it will receive timely payment. This is a major change from pre-1983 when the Kenya Farmers' Association (KFA) was acting as the exclusive agent for donor-financed imports, commercial bank guarantees were not required, and payments to the Treasury were routinely delayed or not made at all.

The bank guarantee feature is not, however, exclusively linked to private firms. Any authorized entity such as the Kenyan Grain Growers Cooperative Union (KGGCU) can compete, but the entity must have a bank guarantee. (The KFA was disbanded in 1984 and the KGGCU is attempting to be a successor. See pages 34-5 for more detail.) The bank guarantee is significant because its use overcomes the Government objection to private firms that the Government runs a higherrisk of nonpayment by private firms. It is noteworthy that the bank guarantee feature was not mentioned in the Program Agreement. AID, nevertheless has played a major role in facilitating and monitoring the process, including employing Price Waterhouse to monitor and report on the entire import allocation-bank guarantee process.

Taken together, the conditions attempt to address, and essentially achieve, the limited objectives of improving government coordination in fertilizer distribution and increasing the level of private sector participation in fertilizer distribution. The program is particularly notable because it has substantially influenced other donors to open their aid-financed fertilizer imports to distribution by private firms. The World Bank is the prime example. The Dutch, who are the other major bilateral source of fertilizer, still prefer to use the KGGCU as their sole agent because they feel the KGGCU is best situated to supply fertilizer to smallholders. The KGGCU has approximately 44 retail outlets. The agricultural input distributor with the second highest number of outlets is MEA Ltd., with three outlets.

3.3.2 Next Steps in Liberalizing the Fertilizer System

To provide some perspective on the present set of conditions and performance it is useful to outline what remains to be accomplished in the fertilizer distribution area. A simple list includes the following points:

1. Adjustments within the existing system
   - allow private firms to tender directly against donor-financed fertilizer imports, i.e., it would no longer be mandatory that the government import all donor-financed fertilizer for resale to distributors; instead firms would import in the same manner as they do in any commercial import transaction;
   - relax the price ceiling to allow a pass through of costs of less than 50 kg. bags;
   - permit end-users, e.g., large estates and co-ops, to import directly instead of using authorized agents;
   - convince all donors to allow all qualified private firms to distribute donors' fertilizer;

2. Longer term undertakings

- increase the degree of competition in the retail link of the distribution chain;
- increase the availability of fertilizer to small users;
- educate/train smallholders on application of fertilizer for maize;
- replace the system of administered prices with one of pricing guidelines, monitoring and official authority to intervene under prescribed conditions.

It is anticipated that private firms will be permitted to tender for fertilizer imports directly against AID and other donor funds when a pending ten-million dollar World Bank loan is finalized. The World Bank program is patterned on the 1984 AID fertilizer loan.

Flexibility to allow a higher price for small amounts of fertilizer was a condition in the 1984 AID program but the change remains to be implemented. Price flexibility is necessary for distributors and retailers to be willing to sell in the small amounts required by a large number of users.

Price markups for less than 50-kilogram units may already be widely practiced. The evaluation team observed that several "stockists" (small general stores) in one agricultural town were openly selling fertilizer by the kilogram from open 50-kilogram bags for a price 25 percent above the official maximum price. (The official price is 280 Kenyan shillings per 50-kilogram bag versus the stockist price of 7 shillings per kilogram, equivalent to 350 shillings per 50-kilogram bag.) Within this area, the one kilogram price was found to be uniform among stockists. Price flexibility for less than 50-kilogram units could be officially sanctioned as an interim measure without impairing the official price administration

system and such flexibility does not appear to threaten any special interests. The fact that there is an extremely strong argument to permit flexibile pricingy, that the change would be simple to implement and that it is not a threat to the system--indeed it improves the system--illustrates the extreme difficulty that is encountered in achieving even minor price policy changes. As noted earlier a study of fertilizer pricing will start in July 1985. It is possible that with the reassurance of a study the government may be willing to allow prices to reflect costs more closely without entailing the use of further conditionality.

Fertilizer end users may not import the product. Estates and farmers' cooperatives make specific arrangements with firms to act as their agents to import fertilizer on the users' behalf. Allowing end users to import fertilizer directly would make the entire system more competitive and tend to exert pressure on fertilizer distributors to direct more of their efforts toward the more complicated task of providing fertilizer to smaller users.

A major aspect of AID's development effort in Kenya is to increase smallholder productivity and an important part of this effort is establishing the efficient and widespread provision of fertilizer to smallholders. The means to this end is a competitive private sector working at the wholesale and retail levels. Development of the retail link and expansion of the the availability of fertilizer to smallholders has yet to be explicitly addressed in any donor program. Most smallholders use little or no fertilizer on food crops and it is reported that most smallholders are not aware of the value of fertilizer or of the technical aspects of its application. Thus an

increase in the availability of fertilizer to smallholders and promotion of its use involves a set of measures:

- establish a policy environment, assistance and a set of incentives to encourage distributors to increase their efforts to supply stockists, co-ops and other retail outlets;
- debulk fertilizer into small amounts, experimenting with packages containing instructions and the proper amounts (ratios) of fertilizer, seed and insecticides (most farm households have members who can read such instructions);
- establish a marketing program for distributors and stockists to encourage smallholders to use fertilizer, combined with efforts by extension agents to encourage and instruct farmers on fertilizer application;
- deregulate retail prices of fertilizer sold in small amounts and prices of input packages.

Observers note that a major effort to promote fertilizer application to maize by smallholders is at least two years away. All agree that it will require a specific, coordinated effort to achieve widespread application of fertilizer by smallholders.

It will not be possible to make substantial gains in the efficiency of the fertilizer distribution system and in efforts to increase smallholders' use of fertilizer on maize under the present regime of administered pricing. The administered pricing system is intended to insulate farmers from upward spikes in the international price of fertilizer and to prevent middlemen from making excess profits. The two instruments to achieve these objectives have been essentially fiat input and output prices, announced each year, and close regulation of plus direct government involvement in the import-distribution system. The distribution system now has a somewhat greater scope for operation but firms remain hamstrung by the fixed

input and output prices. The pricing system does not allow firms to make rational decisions on quantities and types of fertilizer to import, investment, innovation and expansion into new markets.[1]

The single greatest problem is the delay in announcing the official ceiling price. Late announcement causes fertilizer deliveries to be delayed beyond critical times in the crop production cycle. Thus the ideal of protecting farmers from high prices works in practice, on occasion, to deprive producers of fertilizer at any price or to cause late delivery and diminished yields. The excessive profit problem perceived by officials can be largely resolved by encouraging open competition among distributors. The pending fertilizer pricing study will hopefully yield recommendations that will serve as a basis for formulation of a more liberal pricing policy while providing some mechanism for contending with upward spikes in c.i.f. fertilizer prices.

3.3.3. Significance and Realism of Conditions: Maize

Liberalization of the maize marketing system, a second point of major emphasis in the AID SAP, is also important. Maize is the single most widely cultivated crop in Kenya and it is the main consumption staple for the country. The overwhelming importance of maize in Kenya is one of the reasons why it is so difficult to achieve significant policy changes.

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[1]There is recognition, in principle, of the need to allow prices to cover costs. In 1984 and 1985 marketing margins allowed by the official input and output prices were apparently adequate to attract distributors.

The official marketing/pricing system yields disadvantages similar to those of most official systems except, because enforcement is relatively thorough, the degree of harm may be greater than in many sub-Saharan economies with similar official systems. Analysts criticize the Kenyan system because, relative to a competitive market and depending on prevailing market conditions, the Kenyan official system tends to destabilize producer prices (and incomes), depress producer prices (and incomes), subsidize consumer prices, cause excessively high marketing costs, discourage private investment in storage, and prevent development of a maize market and of entrepreneurs.

In principle, therefore, an effort to liberalize such an important and inefficient economic activity is highly significant. In the 1984 Program Grant, three conditions precedent refer to maize marketing, two of which (A and B on page 92) encourage the GOK to administer the price system according to the government's own dictates. The two conditions are not significant in a policy sense, but they are consistent with AID concerns because the conditions affect farm household income (timely payment to farmers by the NCPB for maize deliveries and increase the official producer price of maize). The condition that calls for the GOK to allow private dealers to purchase 90,000 tons of maize for sale in the domestic market is substantive and, given the tightness of regulation, it is significant even though it is a partial measure.

The 90,000-ton condition appears to be more concrete than it actually is. The condition does not ask for reversion to the terms of the Maize Marketing Act of 1959 or for liberalization beyond the terms of the Maize Act, or for diminishment of NCPB operations. Instead the condition is a

quantitative statement devoid of performance or implementation details. It is also not apparent how performance can be measured because legal, privately marketed maize is not systematically recorded. There is no definite means of knowing if an incremental 90,000 tons of maize flows through private channels.

How much is one million bags of maize? The estimates of maize production and the share of production marketed through all channels vary. For example, a 1983 study lists four different estimates of total maize production in 1980-81. The high and low estimates differ by 46 percent (1.64 million tons to 2.4 million tons). Keeping in mind the usual reservations about inaccurate data, a total maize production figure of 2.386 (metric) million tons in 1981-82 with a marketed amount of 835,100 tons (35 percent of total): means that one million bags or 90,000 tons is equivalent to 10.8 percent of total marketed maize production in 1981-82.[1] Ninety thousand tons is equivalent to 13.6 percent of 1981-82 maize sales direct to the NCPB and equivalent to 64 percent of sales to traders in 1981-82. Given that legal sales to traders were near zero in 1984-85, the condition can be interpreted as calling for restoration of private trade in maize to approximately two-thirds of the 1981-82 level. The condition calls for a significant increase in private trade over the prevailing low level of legal trade, but relative to the magnititude of market and price intervention, the condition essentially asks only for a gesture toward liberalization.

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[1]Booker-Githongo, Grain Marketing Study, p. 10 and Table 1.

Was the million bag condition realistic? Was there an appreciable chance of success--50 percent for example? It is difficult to say, but there are two sides to the argument. On the unrealistic side we have the fact that the Condition was summarily dismissed by the GOK with the rationale (almost identical to the one given in 1980) that market liberalization would not occur until production and official stocks were restored to pre-drought levels (no quantity specified). Furthermore, it was known in mid-1984 when the condition was drafted that Kenya was going to have a maize shortfall and that the GOK tended to tighten market controls in times of drought.

On the other hand, there were several major official documents supporting liberalization in principle (see p. 121). The statements outline the future role of the NCPB as a buyer and seller of last resort and as an exporter and importer of maize in response to floor and ceiling trigger prices. These kinds of statements would encourage conditionality writers at least to try for the brass ring, and they did. It is difficult to say that the effort was not worth the risk of having a condition repudiated but, given the AID experience and a similar experience involving the World Bank, there is a distinct lesson: conditionality alone is not likely to yield liberalization of maize marketing in Kenya.

Unlike fertilizer, where some progress has been made, liberalization of maize marketing and pricing policy has yet to start. In recent years restrictions (beyond those prescribed by the law) and enforcement have been so extreme and effective that virtually all private trading, other than small amounts bought and sold locally, has been halted.

The Fifth Development Plan (1984-88) and the Booker-Githongo Grain Marketing Study provide a sound framework for liberalization. The central challange is to explore, in a constructive manner, what the GOK would require to move toward a more liberal marketing and pricing policy. Part of the answer is to be found in puzzling out what the root concerns are of key parts of the GOK. This issue is discussed in the next section.

3.4 Expectations for Liberalization of Maize Marketing and Price Policy

3.4.1 Three Directions

The most elementary set of forecast options for the evolution of the Kenyan policy approach is that: (1) there will be little substantive change, Kenya will maintain its dirigiste approach to maize marketing with occasional exceptions (typically when NCPB purchases of maize surpluses are sufficient to exhaust the NCPB budget and/or fill NCPB storage to capacity, thereby forcing the government to allow purchases by private traders); (2) there will be a trend toward expansion of and greater reliance on large-scale, specialized maize farms to produce for the official system; (3) the system will be liberalized with extensive private trading, storage by both government and private sector, the NCPB will manage the reserve stock, international trade in maize and act as a buyer and seller of last resort (essentially the model in the Fifth Development Plan).

There are forces at work in Kenya which will push the outcome in the direction of either option (2) or (3). The driving force is a four percent population growth rate combined with the binding constraint of lack of unused arable land. In

the 1960s and 1970s, maize production was increased by expanding the area under cultivation and introduction of higher yielding maize varieties. There remains some scope for greater use of hybrids and composites but expansion of area can only be made at the expense of export crop production, thereby decreasing employment and foreign exchange earnings. The alternative, to import maize, also requires foreign exchange. According to the National Food Policy paper of 1981 (Sessional Paper No. 4), the alternatives which use foreign exchange are unacceptable. The National Food Policy paper does, however, call for a 4.9 percent annual expansion in maize production through 1989 in order to rebuild stocks and to keep pace with population growth. The World Bank estimates that with growth in per capita income of 2.5 percent and a 3.5 percent population growth rate, the demand for food will increase at 4 percent per annum.[1]

Given the low level of maize production technology applied in Kenya relative to what is readily available, other "technical" factors and the Kenyan natural and human resource base the agriculture sector is readily capable of producing a sustained increase in maize output; but two major changes will be necessary. First, Kenya must devise a way to encourage farmers to introduce and to sustain technical changes which will increase maize output per unit of land (shift the production function away from the origin) and second, an increasingly larger share of maize production must be

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[1]World Bank, Growth and Structural Change in Kenya: A Basic Economic Report, Annex II: Issues in Kenyan Agricultural Development, August, 1982.

marketed.[1] Because production circumstances are substantially different than they were in the 1960s and 1970s and because previous official maize marketing/pricing policy has tended to destabilize the maize market and discourage production for market, Kenya must make some major decisions soon if is to avoid a chronic loss of foreign exchange earnings and/or increasing dependence on donor food aid. To meet economic demands the present administered system will either have to be drastically overhauled with official decision making linked much more closely to production and growth results, or the existing system must be largely replaced with a market-based system.

Maize yield increases can be achieved through both labor and capital saving techniques including greater use of fertilizer and improved farming practices. But the risks of adopting higher cost techniques and making additional investments are not likely to appear attractive to farmers without major improvement in the policy and organizational framework. Relatively simple production adjustments can make a large difference. For example, Michael Schluter estimates that forgone maize production attributable to delays in planting is

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[1]It might seem that an increase in the market to production ratio would always occur with an increase in productivity; however, the ratio change is not automatic. Output per unit input could be increased with respect to labor (labor saving), to land and purchased inputs (capital saving) or to a combination of the two. If maize farming were to become more labor intensive (capital saving) such that the incremental output per additional worker were just equal to the amount of maize needed to sustain each worker, total output per unit of land would increase but the share of marketed maize would not increase. There would be no incremental maize output for urban dwellers. Conversely, if the productivity gains were made with respect to labor input, then the market to production ratio would increase proportionately--assuming corresponding sales--but the incremental maize production would not absorb any additional labor.

approximately 900,000 tons annually in Kenya (an average of ten days late on one-million prime hectares, with a loss of 90kg. per hectare per day).[1] The typical annual loss in maize production is equivalent to ten times the amount of maize specified for private trading under the 1984 AID Structural Adjustment Program.

It is certainly not clear now what direction agricultural policy will take. There are major, conflicting forces at work. The historical record is mixed and GOK official actions and statements frequently are contradictory. Kenya is somewhat unique in sub-Saharan Africa in that historically farmers have effectively exerted strong influence to gain favorable treatment. During the late colonial period European farmers used their considerable influence to establish official production and price controls as well as institutions to sustain the controls. The result was a marked dualistic system consisting of African smallholders and large-scale European farms and ranches. Although much has changed since independence, farmers' interests have continued to be politically important with producers of foreign exchange-earning crops being the main beneficiaries of the colonial legacy.

Pricing policy has tended to split along the lines of export crops and crops for domestic consumption with producers of export crops receiving higher real and relative prices. Export crop prices have tended to reflect their international parity price. In contrast to much of sub-Saharan Africa, marketing parastatals for export crops in Kenya have not

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[1]Michael Schluter, Constraints on Kenya's Food and Beverage Exports, IFPRI, April 1984, p. 70.

incurred excessively high costs. The Kenya Tea Development Authority (KTDA) has a particularly notable record for efficiency.

There has, nevertheless, been a downward trend in real producer prices for officially marketed production of both export and domestic crops. Between 1972 and 1982 the index for export crops fell at an average annual rate of 0.1 percent and domestic crops fell at 1.3 percent. Jennifer Sharpley finds there was a "sharp deterioration" in the barter terms of trade between the agricultural and industrial sectors as the index fell at an average annual rate of 0.8 percent between 1964 and 1975; and a 1.3 percent average annual decline between 1972-1982.[1] Based on data from officially marketed production and from the net barter terms of trade index, the real income terms of trade index for the agriculture sector grew at an average annual rate of 5.5 percent between 1964-1972, but slowed to an average rate of 2.2 percent between 1972-1982. Thus, real producer incomes from official sales rose 24 percent over the 10-year period. Population, however, increased 40 percent, thus real income per capita from official sales declined.

Official maize and wheat prices were on an approximate par with international prices during the 1970s. Maize and wheat domestic border prices expressed as a percentage of world border prices (at the official Kenyan exchange rate) averaged 114 percent between 1972-78, The ratio becomes 95 percent when a shadow rate in used.[2]

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[1]Jennifer Sharpley, Kenya: Macro Economic Policies and Agricultural Performance, OECD Development Centre, October 1984, pp. 18-19.

[2]Ibid., pp.37-40

Since 1980, nominal maize prices have increased substantially. The farm gate price index moved up from 139 in 1981 to 240 in 1985.[2] Real official prices for maize remained approximately constant.

3.4.2 Ambivalence of Officials

Official documents, GOK actions and the attitudes of GOK officials should provide some indication of the direction policy will take over the next few years. Unfortunately the record does not readily reveal a strong pattern although it is clear that, in practice, maize marketing has become more restricted.

A series of GOK documents and associated papers explicitly endorse liberalization of maize marketing and spell out in considerable detail the form of the new system. (Fourth and Fifth National Development Plans; Booker-Githongo GMS 1983; Inter-Ministerial Working Group draft on Maize Marketing Policy, 1984; Sessional Paper on National Food Policy, 1981). A brief summary of points from the Fifth Development Plan outlines a major shift in marketing policy. The objectives are: to improve farmers' access to markets; to increase the efficiency of food production; eliminate local food shortages; and to improve national food security. The means to achieve these objectives are, inter alia:

-- remove restraints on interdistrict maize movements,

-- the NCPB will function only as a buyer and seller of last resort

-- improve/increase maize storage efficiency, increase on farm storage,

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[2]USAID (cable), Nairobi 4065, February 1985.

-- add to national grain storage capacity for use as a national grain reserve,

-- the number of commodities reviewed for price control will be reduced to a minimum strategic few and the market will set the price for the others.

Government actions since 1980 have been to displace private traders acting as buying agents for the NCPB and to limit private traders to dealing in extremely small amounts of maize. In 1980 the NCPB was instructed to establish 300 buying centers. By 1985 there were 500 buying centers in operation throughout Kenya. The centers were reportedly established because buying agents were offering less than published prices. The buying centers, which are managed by local officials, are reported to have become "employment cows". Aside from the question of agents' offering less than official prices, the buying centers constitute a large, new vested interest in single channel marketing. Since 1982 local officials have imposed maize movement restrictions beyond those in the Maize Marketing Act. Interviewees reported that by late 1984 only small amounts of maize were moving across district lines, legally or illegally, and that there were appreciable difficulties associated with legal movements.

GOK officials virtually vie with one another to list the reasons why liberalization of the maize market is a poor idea. The same officials readily preface their comments with the statement that "in principle a competitive maize market is desirable but...." GOK officials offer several arguments against liberalization of maize marketing.

A standard response to the proposal that there be some movement toward liberalization is that, "when maize production reaches the level such that the NCPB can no longer buy and

store additional maize, private traders might be allowed into the market." In other words, there will be no policy change per se, but the private market will be allowed to function as a safety valve whenever the official system cannot and no longer needs to purchase maize. Officials give several generic reasons why liberalization of the Kenyan maize market is not likely to be accepted on a permanent basis in the foreseeable future. Some of their reasons are, for example:

-- Asians will dominate the trade and the people will resent this.

-- Asians will collude and fix low buying and high selling prices.

-- The farmers need to be protected from the traders.

-- If the countryside were opened to traders they would "skim the market", buying and selling only in the most accessible locations.

-- Traders will export maize out of Kenya to the point that there will be shortages. The people will not be able to buy maize.

-- In times of maize shortage there would be no way to ensure that people can buy maize.

-- If private traders are involved there will be a shortage of white maize requiring the import of yellow maize. When the people can buy only yellow maize they will think there is a famine situation and they will loose confidence in the government.

-- The private sector is not capable of conducting significant trade in maize. It lacks capital and experience and it is too weak or unwilling to make the necessary investment.

In trying to guess what the government position or attitude is and where policy will go, it is useful to keep in mind two points. First, influential Kenyans have widely divergent views on the liberalization issue and, second, it is not a clear-cut case of the government versus the private

sector. The Parliamentary debate on the NCPB in April, 1985, brought out some diametrically opposing views (see Annex 1). Also within government there are differences among and within ministries; some officials in the NCPB would prefer a substantially larger role for traders and competitive markets, and, as is often the case in sub-Saharan Africa, many senior professional government servants favor less state control.

A second important point is that there is not always a clear distinction between the government and the private sector. Kenya is much like many other countries in this sense, including some industrialized countries. Some private firms have strong interests in retaining government controls and regulations which limit competition and boost prices. These firms often have close working relationships with government. In Kenya many high level government officials also own firms or large farms and there apparently is no conflict of interest problem if an official should make decisions which might affect his own business. There is also a set of quasi-government or quasi-private entities, including some co-ops and even some parastatals, whose opinion on the degree of market stress does not fit with their designation. Some parastatals act like private enterprise and many cooperatives, which are considered to be in the private sector, operate as if they were government entities. The KFA was a prime example of the latter.

There are also two potentially extremely significant developments which could influence the future course of agricultural policy: (1) legislation to establish formally the NCPB; and (2) the rise of the Kenyan Grain Growers' Cooperative Union (KGGCU). The outcomes of both of these developments are yet to be resolved. The National Cereals and Produce Board Bill was published on July, 1984, and Parliamentary debate on the

bill was started in April, 1985. The purpose of the bill is to establish formally the NCPB entity which was created from the merger, in 1980, of the Maize and Produce Board and the Wheat Board. It is difficult to say how significant the bill will be once passed, because actual practice and enforcement can vary in either direction. Nevertheless, the draft bill and the debate provide some insights.

The draft bill essentially states that NCPB functions will be to regulate and control collection, movement, storage, sale, purchase, transportation, marketing, processing, distribution, export and import of maize, wheat and scheduled agricultural produce. If there are any doubts, the language suggests that the government genuinely intends to follow a pervasive, single channel maize marketing system.[1]

The bill also calls for the NCPB to appoint a main agent who may appoint sub agents. This system was used before 1980, when the KFA was the main agent concentrating its efforts on large-scale maize farms in the Rift Valley. The KFA was recently disbanded and replaced by the KGGCU. The latter is most likely to become the NCPB principal agent if this part of the bill gets through Parliament.

If passed as drafted, the government will have sent a strong signal to the donor community that, in spite of stated commitments to the principle of a competitive maize marketing system, significant movement is not likely to occur in the foreseeable future. Observers are uncertain about why the new bill was a virtual duplicate of the original legislation, but

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[1]Keruingi, Felix. USAID Nairobi, memorandum to David Lundberg, 3-28-85.

some suggest that retention of the colonial-origin provisions only reflects a kind of bureaucratic inertia in which the old material was simply copied to expedite the process of obtaining a legal mandate for the NCPB. Nevertheless, the draft legislation is not encouraging. The absence of points from the Fifth Development Plan or from the Booker-Githongo Grain Marketing Study must be interpreted as a significant indicator of basic government intentions.

The Parliamentary debate in April was lively. A brief newspaper account of one day's debate is reproduced at the end of the chapter. The breakdown of Parliamentary opinion is not known but some MPs apparently hold diametrically opposing views. It is not known now when the legislation will be finalized.

The emergence of the KGGCU is also a potentially powerful factor which could encourage and contribute to implementation of a freshly legislated government mandate to control maize marketing. In addition to functioning as the principal agent of the NCPB, the KGGCU has the stated aim of becoming the monopoly fertilizer distributor in Kenya. The concern here is not that the KGGCU might actually succeed, but that it be given special privileges--regulations, exemptions, contracts--thereby seriously impeding investment in and development of the agriculture input industry.

It is not possible to say at this point how the KGGCU can be expected to evolve. The KGGCU (the Union) is the successor to the KFA. The KFA had nebulous charters as both a cooperative and a corporation (allegedly depending on which designation was most advantageous for the occasion, for example, tax exemption or corporate reporting). The KFA was

originally organized by European farmers with membership restricted to large farms. After independence the KFA relaxed its membership requirements to include smallholders. By 1984, the KFA had about 10,000 members. The organization was the largest agricultural input distributor in Kenya with 44 retail outlets, the exclusive agent for distribution of donor-financed inputs, and it was engaged in numerous agriculture-related activities, for example, storage and credit. The KFA had become become involved in several disputes with the government with each side making financial claims on the other.

In 1984 the KFA was disbanded by the government and its assets, organization and 10,000-farmer membership taken over by the KGGCU which claimed a membership of 200,000 farmers. In the space of a few months the Union, according to its own count, expanded its membership by an additional 90,000 farmers.[1] The KGGCU states that it is not a government entity because it is a cooperative. The Union recently requested from government and was granted several major exemptions from the rules governing cooperatives. The stated aims of the Union are to become the exclusive buyer of regulated commodities (which includes maize) and the the single seller of farm inputs.

3.5 Concluding Comments and Recommendations

3.5.1 Comments

The results of the 1983 and 1984 ESF Structural Adjustment Program in agriculture are mixed. First, it is

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[1]Interview with KGGCU officials at KGCCU headquarters in Nakuru, April 19, 1985.

noted that only three of the conditions in the program concerned structural adjustment; that is, to bringing about a change in policy that relate significantly to a significant structural variable. Most of the conditions were efforts to extract better performance from the existing system.

To summarize the program and results it is useful to divide the conditions into three groups of conditions: (1) those which attempt to effect structural change; (2) those which attempt to obtain change within the existing system; and (3) conditions which are intended to improve performance without changing policy or making adjustments within a policy framework. The grouped conditions, performance and commments on significance are listed in Table 1.

Classification of a condition as one which does not attempt to effect a policy change is not a criticism per se. The specific design of a condition depends on circumstances. Group-two adjustment conditions can be useful although there are strong reservations about group-three conditions.

Of the three "structural adjustment" conditions, only the one asking for allocation of donor-financed fertilizer to private firms was accomplished. The condition asking for upward price flexibility of less than 50 kg. bags of fertilizer was not met and the government indicated it was not likely that private dealers would be allowed to purchase 90,000 tons of maize. This last condition may be satisfied by default, however, because the buying season is in the fall of 1985 when a larger than normal maize harvest is expected. There was better progress in obtaining changes within the existing system, although progress has been slow, e.g., timely announcement of the official fertilizer price. Improvement

occurred in the coordination of fertilizer imports but by a somewhat different organizational arrangement than the one requested. It is noteworthy that no appreciable progress was made in any of the three pricing conditions.

In the area of maize marketing, little concrete progress was realized. Recent experiences of AID and the World Bank indicate that the GOK is not willing to allow private traders to operate even at a level below the one permitted in the National Maize Act. This position is not encouraging and the cause of considerable consternation. Because the outlook is poor, it is tempting not to risk failure in the future by any effort to obtain policy change. But the area is too critical to AID interests--long term growth--to ignore.

AID can and should maintain a presence and maintain pressure for reform of grain marketing for two general reasons. First, an active policy dialogue process directed at increasing the scope of market forces may help prevent further diminishment of the market system in Kenyan agriculture. Second, AID can contribute to building the analytic case for a competitive market system and develop approaches which would move toward liberalization while taking GOK concerns into account. In the event there were to be a shift in the GOK attitude in the course of this policy dialogue process, AID would then be in position to make specific, well-informed proposals.

In spite of the lack of policy changes, considerable foundation work has been accomplished. First, policy reform in maize marketing has become a major issue. Second, the Booker-Githongo GMS provides a major policy dialogue point of reference and can be used as a basis for discussion of specific issues.

Table 3.1. Summary Assessment of the AID 1983-84 Structural Adjustment Program for Agriculture

Condition	Performance	Comment
1. Structural Change		
a. Government fertilizer imports will be sold to any licensed fertilizer dealer.	a. Program in second year of operation. First year 6 firms participated. In second year 29 firms received import allocations and 13 of the 29 acquired bank guarantees.	a. Significant in policy sense.
b. GOK will establish a policy authorizing a surcharge on fertilizer packages of 25kg. or less. (covenant)	b. No response.	b. Minor in a policy sense, thus measure could arguably be placed in Group 2. Important in effort to channel fertilizer to smallholders and a dinstinct break with uniform price policy.
c. Private entities may purchase at least 90,000 tons of maize.	c. Response indicated that purchase not likely to be allowed but buying season still 4-5 months in future. Result not yet known, purchases may occur in spite of GOK negative response.	c. Significant policy issue but condition per se does not require policy change.
2. Changes Within System		
a. Establish the FAC to adivse, guide on prices, coordination of fertilizer imports, identify private importers.	a. Accomplished	a. Given the lack of coordination in this area and the costly delays this is a useful measure.
b. Evidence of steps (1) to develop integrated food security policy, (2) to reduce NCPB deficit, and (3) to study management and organization of	b. Evidence for (1) and (3) provided' (2) no clearly identifiable evidence of a response.	b. Points (1) and (3) are important intermediate steps. No. (2) is more of an exhortation than a condition.
c. Do not restrict fertilizer imports or foreign exchange for such imports.	c. A moot issue because firms not able to import all fertilizer (donor financing) available.	c. An important area but not an issue. The problem lies elswhere.

Table 3.1 (continued)

Condition	Performance	Comment
d. Evidence of timely publication for stock levies, donor financing intensions, compilation of commercial fertilizer imports applications.	d. Substantial progress has been made but process is still being developed.	d. An important "housekeeping" issue.
e. Announce wholesale and retail fertilizer prices by November each year beginning in 1984. (covenant)	e. The November 1984 announcemenet deadline was not met. Prices were announced in March 1985. 1985 performance yet to be observed.	e. An important issue and warrants continued attention.
f. Complete review and revision of fertilizer pricing structure. (covenant)	f. Study to be started in mid-1985.	f. An important issue and warrants continued attention.
3. Encourage System to Function as Prescribed		
a. Submit a report on resolution of problem of timely (late) payments by parastatals and coops to farmers and announce that cash payments to producers is to be the procedure.	a. Letter received from Treasury indicating problem is rectified and that cash payment is the standing procedure.	a. No policy significance but helpful to others.
b. Evidence that GOK will increase controlled/procurement prices of grain in accordance with procedure.	b. Controlled prices were increased as announced.	b. No policy significant but helpful to others.

While tangible progress has been made in increasing private firms' involvement in fertilizer distribution, the situation warrants considerable caution. As the KGGCU becomes fully operational it may be able to convince the government to revert to the old exclusive agent system and eliminate or severely restrict competition from private firms.

The fertilizer area offers the greatest potential for further movement. It will require a relatively active approach but fertilizer accommodates this because there are several incremental, specific objectives, for example, allow end users to import fertilizer directly or allow firms to tender directly against donor programs. Significant progress in increasing competition at the retail level and increasing use of fertilizers by smallholders will depend on gaining more flexibility in pricing. So far there has been negligible progress in the pricing area. The prospect for improving fertilizer policy is also promising because it is possible to create a tight bond between conditions and assistance to facilitate implementation, for example, conditions on price flexibility accompanied by provision of fertilizer, aid to improve farmers' education on fertilizer use and assistance to stimulate private firms to compete at the retail level.

3.5.2 Recommendations

1. The maize marketing question is important and should not be abandoned as a prime policy issue. Expectations, however, should be lowered and the approach to getting policy change should be shifted from use of conditionality to a search process in which key issues are identified and examined jointly by the GOK or an approved Kenyan entity and AID, plus any other interested donors. USAID Nairobi should explore establishment of a staff-level U.S.- or donor-Kenyan group for informal

discussion of costs and benefits of the present system versus a liberalized version.

2. Systematically collect and refine GOK arguments against maize market liberalization. Conduct a preliminary examination of the set of arguments. Examination of each argument should incorporate both political and economic aspects. Use the recommendations in the Booker-Githongo GMS as standard alternatives. Discuss findings in the course of policy dialogue with the government or, if there is a grain marketing discussion group, incorporate the findings into the discussion.

3. Develop a proposal for an experiment to test the effects of gradual maize market liberalization. It is suggested that three or four adjacent districts incorporating net maize surplus and deficit areas be identified as the experimental group.

4. The AID fertilizer program is a significant activity with appreciable potential for further progress; therefore, continue to develop the program. Specific points are:

-- The USAID should make a special effort to be involved substantively in the 1985 fertilizer pricing study, although the involvement should be informal. To the extent possible, discuss the study with the author during the course of analysis, comment on any drafts and otherwise maintain a substantive presence.

-- Monitor the development of the KGGCU and to the maximum extent possible oppose moves to establish the KGGCU as an agent for the NCPB or as the single seller of fertilizer to smallholders;

-- Although specifics await the completion of the fertilizer pricing study, initiate preliminary work to formulate a plan spelling out how the GOK can replace the system of administered pricing with a market-based pricing system,

supplemented by measures responsive to important government concerns, e.g., (1) a government system to monitor domestic fertilizer prices and (2) a system to define and dampen spikes in prices of imported fertilizer.

-- Continue to seek specific objectives which will increase the degree of competition in fertilizer marketing such as direct tendering by private firms and direct import by end users;

-- Initiate preparation of a plan, including necessary analyses, on how to increase competition at the retail level, to increase availability of fertilizer to smallholders and to encourage and train small farmers on the use of fertilizer. When the plan has reached an intermediate stage it should be made a standing discussion topic with the GOK with consideration given to making further development a joint GOK-AID activity;

-- Develop a plan to experiment with liberalization of fertilizer prices in two or three adjacent districts.

5. Discontinue the the use of conditions which require the government or parastatals to act according to already established laws or regulations.

CEREALS BOARD BILL OPPOSED[1]

The MP for Wundanyi, Mr. Mashengu was Mwachofi yesterday opposed the National Cereals and Produce Board Bill saying validation would give it a monopoly, kill the farmers' initiative and sever the much cherished free enterprise policy in Kenya.

Saying Parliament was merely being asked to approve what had been there for five years legally, the MP argued that there was no need to legalize a body which did not change the food situation in the country for the time of its existence.

He felt talking about free enterprise, then talking about controlling the farmers' marketing, pricing and transportation of his produce was like mixing "Adam Smith and Karl Marx."

Mr. Mwachofi said there could never be sufficient food in the country, if there were no incentives for farmers.

He said the proposed Food Tax by some MPs was dangerous and frightening. "The people themselves must produce the food," he said. He also noted that the Minister for Agriculture and Livestock Development when moving the Bill had said there would be amendments and so he was "tabling a Bill which has something wrong."

He also felt that there was no need for starting another parastatal when there were problems with the existing ones.

He said parastatals had their roots in the colonial era and were meant to subsist on the peasants.

The Minister for Water Development, Mr. Jeremiah Nyaga, supported the Bill saying the new board would help the country to regulate, control and market produce.

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[1]From The Standard (a Nairobi daily newspaper), April 4, 1985, Nairobi.

He said the Board should go right into the rural areas because transportation was too high and always made prices go up.

The MP for Mathira, Mr. Matu Wamae, said there should be up to 10 million bags of maize in reserve, adding that money for the storage should be obtained somehow by taxing the people.

The MP for Kwale Central, Mr. Boy Juma Boy, said that farmers were plucking out Bixa trees because of the poor prices.

He said farmers had been milked a lot and the Ministry concerned should protect them.

Moving the bill Mr. Odongo Omamo had said Kenyan agriculturalists are researching on high breed yellow maize.

The Minister said it was wrong for Kenyans to wait until all the white maize was consumed, and then introduce them to yellow maize. This looks suspicious.

He said yellow maize was very nutritious and so the Government had instructed researchers to study the possibility of Kenya growing high breed yellow maize.

The Minister told the House that the NCPB had a current stock of over four million bags of maize.

He, however, declined to say whether it was white or yellow maize.

4. INSTITUTIONAL REFORMS

4.1 Improved Analysis, Planning, Budgeting and Financial Management in the Ministry of Finance and Planning

4.1.1 The Program Output

The June 1983 Grant has one Condition Precedent and two covenants aimed at improved planning and budgeting. Condition Precedent six requires "assurance that new investments in the public sector will be reviewed for economic, financial and technical soundness and will be approved in accordance with an investment plan and an external borrowing plan." In the relevant covenants the GOK agrees:

> to develop a plan to ensure that scarce budget resources are allocated to high priority investments and that investments of lower priority for which there are insufficient budget resources are either curtailed or permitted..., ...to establish a special mechanism to manage planning, budgeting, monitoring and implementation of externally-financed development programs...

The $2 million technical assistance grant that was part of the June 1984 ESF transfer gave the rationale for including management/institutional elements in the program: Successful implementation of the structural adjustment process now requires, in addition to major balance of payments and budget support, expanded and improved staff work in the operating, planning and finance ministries.

Five specific instruments were to achieve this goal are the following:

- technical assistance to the Ministry of Agriculture and Livestock Development: [$900,000 for continuing support of the Technical Assistance Pool (TAPS), i.e., the Harvard Institute technicians];

- a $250,000 grant for improving budgeting in the MFP, and introducing better control over aid projects;

- a $650,000 fund for studies dealing with public enterprise divestiture issues; the Monopolies and Prices Commission; import monitoring; export promotion; use of microcomputers;

- introduction of microcomputers and related services for use by the TAP and the Ministry of Finance.

These components (plus $50,000 for evaluation) account for the planned use of the $2 million 1983 technical assistance grant.

The September 1984 CIP Grant Agreement contains only a few brief covenants (and no Conditions Precedent) bearing on reform of budgeting/planning. The GOK agrees (Section 5.12) to "continue with refinement of its budgeting process, both annual and forward budgeting...." It agrees (in Section 5.3) to hold its budget deficit to five percent of GDP, and (in Section 5.14) that "it shall include the development budgets of all 25 major parastatal bodies parallel with the Budget Estimates for 1985/86."

The Letters of Implementation and GOK responses ran as follows:

-- on 21 June 1983, the Embassy requested from the MFP "a letter from the Ministry of Finance containing assurances that the decision has been made that new investments in the public sector will be reviewed for economic, financial and technical soundness and will be approved in accordance with an investment plan and an external borrowing plan."

-- On June 24 the Permanent Secretary satisfied that condition (and all the others requested) in a brief letter. On budgeting, he wrote: "With regard to public sector investment plan (sic) the Government expects to have a

forward budget covering all the years of the Fifth Development Plan completed by the end of September 1983. In this connection the Government has requested technical assistance from the World Bank to assist in the exercise and such technical assistance should be available about the middle of August."

4.1.2 Significance of the Issue

The project output language refers only to improvements in the Ministry of Finance. But the technical assistance component covers TAP work on better budgeting in the Ministry of Agriculture and Livestock Development (MOALD) as well. We therefore consider the overall budget reform question here, rather than discussing MOALD budget improvements in the agricultural section of our report.

Better budgeting and more effective and efficient use of public sector resources is certainly a priority objective. Dispersion of resources on new projects while old ones limp along, and continuation of clearly low priority programs are certainly major impediments to faster, higher-quality economic growth. And unless the economic decision-making institutions of government are strengthened now, resources will be squandered on ill-considered projects later, when present economic constraints ease.

In Kenya, as in most LDCs, rational economic decision making and effective economic management are distant goals. Kenya's decision-making institutions and procedures, while relatively orderly and well-defined by LDC standards, are deficient in many basic respects.

Project generation is supposed to be the responsibility of operating ministries and parastatals. In a few cases, it is.

But in most cases projects are hatched and developed outside, by donors and private project peddlers--promoters, machinery salesmen, "investors" of various descriptions. Once launched, there is little to stop bad or low-priority projects. Sectoral ministries are suppose to do internal evaluation. In practice they are only transit points; most ministries simply send forward project proposals originating usually from collaboration between their own technical staffs and donors, or from "their" parastatals. They have too little expertise, too little time and too little incentive to do serious vetting.

Screening procedures for new expenditure commitments at the center of the government, the MFP, are hardly such as to provide assurance that "rational" decisions will occur.

- With respect to projects, one level of screening is supposed to occur at the forward budget stage. But when projects are presented for inclusion in the forward budget they are already mature, with a life of their own; often they are faits accompli. So they are simply included in the forward budget without much real evaluation.

- It is in the annual budget process that final project approvals take place, but vetting arrangements here are also highly imperfect. The MOFP Investment Division, which is supposed to review parastatal and other project proposals, is very thinly staffed and has never functioned well. All new projects are supposed to be accompanied by briefs and to receive comments by the ID and the Project appraisal unit (PAMD). But in practice these analyses and comments are rarely available, or provide only rudimentary analysis. The Sector Planning Groups, which are supposed to do analytic work on new projects during budget preparation, are in fact the scene of little discussion of the feasibility or priority of new projects. (The SPG often don't meet at all.) The key budget-making units, the Estimates Working Groups, are always absorbed by the problems of cutting aggregate requests to meet overall ceilings. They have no time and little capacity to go into the quality of new project proposals.

- According to its own guidelines (1982 and 1983 Treasury Circulars) the MFP is supposed to formally evaluate

and approve all projects with total investment costs over $347,000, including parastatal projects. But, as noted above, the machinery for evaluation and approval is entirely embedded in the budget system. Inevitably, budget preparation leaves too little time for serious discussion of project proposals. Since the number of proposed projects is large, discussion in the Estimates Working Groups is generally perfunctory. Moreover, the linking of project vetting to the budget process tends to lead to neglect of proposals that rely on extra-budgetary resources. Since foreign aided activities and parastatal investment fall in this category, and provide the bulk of government investment, it is easy to understand the extent to which commitment of development expenditure are out of control.

Recurrent expenditure is if anything less "rational" in its allocation than development expenditure. This is of course so everywhere; all budgets are repositories of past history and politics. Americans scarcely need reminders in 1985 of how hard it is to cut budget programs, no matter how dubious their utility or priority. And that is true in the U.S. system, where knowledge and analysis are abundant, government operations transparent, the political and social system stable.

In Kenya, in any case, there is very substantial budgetary "misallocation," an abundance of spending on low priority activity. One well-known general example is the imbalance between salary and nonsalary expenditures, which is common across all ministries. But within ministries, allocations among programs are often awry. Examples can be found in all ministries. The following are from the Ministry of Agriculture and Livestock Development--a critical ministry for national development.

- Over 80 percent of the recurrent budget of the Ministry is now spent on salaries, and the development budget contains additional salary costs. Large new agricultural training facilities are being completed, and many new graduates will be emerging, with rights to government posts. Without

some radical changes in policy, the entire recurrent budget will very soon be absorbed in hiring, and even this will leave many new graduates without a place.

- Irrigation projects, most of them failures, absorbed 25 percent of the MOALD budget between 1981-1985. The National Irrigation Board projects in the forward budget period 1985/86-1987/88 presented a request that amounts to over 50 percent of the projected total MOALD budget. The value of output in most schemes is below variable costs. Resources destined for the profitable MWEA scheme are being siphoned off to sustain the losing NIB operations. Despite permanent financial problems, the Board plans to expand hectarage under irrigation.

- The National Cereals and Produce Board proposes to spend $31.5 million on new grain storage facilities, mostly with aid from Japan, France, Denmark. Current storage capacity is almost 800,000 tons, and NCPB estimates near-term need at 1.1 million tons. The recurrent cost implications of such plans, if realized, are ominous. The NCPB now receives a subsidy from the MOALD budget to cover losses on its trading operations, due to the inadequate spread between its buying and selling prices. The Board lost an average of $14.0 million a year between 1980-83 on commercial imports of wheat, maize and rice. Losses in the drought year 1983/84 will be even larger. The NCPB has therefore asked for a total of $217.4 million during the upcoming forward budget period, an amount that is much larger than the total MOALD development budget.

- The parastatal sugar companies are asking for about $14.3 million a year in 1985-88, to cover debt repayment, operations, equipment, some expansion. The viability of some of these operations is in doubt.

- Recent consultant reports and internal analysis indicate that the MOALD annual health services could save up to $8.6 million a year by privatization of some services, some feasible cost cutting, more and better administered user charges.

- The MOALD's Land Resources Development Division maintains a land clearing service, the Plant Hire Service(PHS). The PHS has 120 crawler tractors in its park. Only 78 are operating. They want 40 more in the next five years, 24 of them from 1985 to 88, at a cost of about $5.7 million. This division also needs an annual subsidy of one million dollars for operating deficits. Studies indicate that PHS

fees cover between 5-15 percent of their costs. Similarly, the Tractor Hire Service covers less than 20 percent of its real cost of operation. Yet it is extremely inefficient; a 1982 comparison of productive hours per tractor showed the private commerical hire services were almost ten times more efficient than the Government service. There is, in fact, no real need for the public sector tractor hire operation; private operators already provide most of these services; they are responsible for 44,000 of the 50,000 ha. of tractor cultivation that occurs on small holdings.

Forward Budgeting: As noted above, the AID Structural Adjustment Program put down a condition that new projects be reviewed and a public investment plan be developed. The GOK authorities, in response, pointed out that the government's forward budget would contain such a public investment program. Some of the deficiencies of the forward budget process have already been mentioned, but more should be said, given the potential importance of the institution in terms of improved decision making.

The forward budget concept is new in Kenya, and this partly explains its problems. It is not taken seriously by spending agencies. It has no legal status, and in fact is regarded as an internal Treasury exercise. The relevant budget ceilings that should guide operating agency responses are not taken as binding. In fact they have been frequently changed, which is not surprising, given the difficulties of predicting revenues. The consequence is a further reduction in the credibility of the exercise. There are in addition some other critical exercises.

- The forward budget is supposed to tie together the Development Plan and the Annual Budget. But development plans rarely provide concrete programs of action. In Kenya, for example, the Fifth Development Plan, 1983-88 contains ministerial forward budgets for each year of the

Plan period, but does not have a comprehensive set of projects and programs for each ministry. In some cases (health, for example) broad programs are described, but few projects or physical targets. In major sectors (agriculture, industry, energy, transport) scattered program descriptions can be found, and some physical targets, but no systematic linking to required outlays. The absence of project lists marks a major problem. The projects on which the Plan's sectoral projections are based are very unevenly developed; some are well-studied, and ready to go, others are not. To take this unevenly developed and analyzed set of projects and proposals as the basis of a serious forward budget projection is highly unrealistic.

- The sheer arithmetic of budget making, and the usual preoccupation with keeping expenditures within some ceiling, prevents much meaningful analysis of forward budgets. The typical budget estimates contain some 356 votes (for spending units like ministries), 125 sub-votes and about 450 heads (recurrent estimates). The number of sub-heads is more than a thousand, and there are several line items under each of these. On top of this, there is the development budget. So the forward budget cannot be given much analysis, given the time constraints.

- Parastatal budgets are also supposed to be included in the forward budget. This was tried in 1983/84: 32 major parastatals were asked to send in budget projections. The information either did not come or was not usable in a number of cases. So it continues to be the case that parastatal investments financed outside the budget escape Treasury scrutiny, and an integrated public sector budget remains beyond reach. Just how big a share of investment is involved is not known, but it is probably large. One World Bank study estimates that at least half the funds used by parastatals for capital expenditures flow outside the budget.[1]

4.1.3 Effectiveness and Efficiency of Instruments

Three main SAP instruments aim at better planning and budgeting: technical assistance, wider introduction of

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[1] IBRD, Public Expenditure Planning in Kenya, Report #5177-KE, June 1984. This section relies heavily on the cited source.

computers, and special studies. At a different level, a certain number of "specific policy targets" or "verifiable indicators of progress" are set down either in the program agreements or in the USAID Quarterly Program Reviews. We will consider the appropriateness or effectiveness of each of these instruments and indicators of progress.

Technical Assistance: Resident advisors and short-term consultants in the MOALD have been supported by USAID's SAP, as well as by other donors, mainly via the TAP managed by the Harvard Institute for International Development. The Harvard advisors are also working in the Ministry of Finance and Planning supported by the AID Rural Planning II Project. HIID has been present for a decade, so the SAP is simply continuing the financing of an ongoing technical assistance effort in the MOALD. Attachment one lists the advisory personnel provided since 1981 and indicates the range of their activities.

The TAP arrangement has brought to Kenya a large number of highly skilled and experienced advisors and consultants. It has ensured a certain degree of donor coordination in the supply of technical assistance to the two ministries in question. The contributions of these expatriate technicians have been substantial.

- They have prepared numerous policy papers of high technical competence;
- They have arranged for high quality advanced training for numerous Kenyans; 14 had studied in U.S. or British universities as of the end of 1984;
- The TAP staff in the MOALD has made some innovative departures in budget reform--notably by a joint task force approach that has encouraged effective dialogue and broadened understanding of obstacles to reform. (This experiment is discussed in detail below.)

- The TAP in the MOALD has in recent months intensified its activities with respect to in-house training;
- The TAP Rural Planning Unit made some unanticipated contributions in addition to their ongoing work: they provided timely assistance in the 1984/85 drought relief effort and they helped in spreading computerization in the MOALD--of which more later.

Despite these positive contributions--and others not mentioned--these are unsettling aspects of the TAP and related programs, notably their impact on long-term institutional development. According to some observers, the MFP and the MOALD are as weak now as they were a decade ago, and in some respects they may be weaker. (Not everyone agrees with this assessment: some old hands say there are now many more Kenyans in responsible positions than there were a decade ago.) But almost everyone recognizes that some profound problems have accompanied the presence of so excellent and numerous a cadre of expatriate advisors. Most important has been the tendency, common everywhere but very pronounced in Kenya, for senior officials to rely on expatriate staff because they can produce quicker, generally better work than their younger, less experienced, usually less well-trained, and much less well-paid Kenyan staff. A dependency relationship has developed, with senior officials more and more accustomed to rely on their foreign advisors. Even more disturbing is the apparent tendency for Kenyan staff to be excluded from the most meaningful work, for them to be largely relegated to data collecting, research assistant-type tasks. According to some reports, junior Kenyan staff never even see most important agency memos much less contribute to their preparation.

The expatriate presence then, while it has resulted in high quality analytic work, has at the same time led to Kenyan staff

alienation and has diluted learning on the job. Few Kenyan staff have learned to do the kind of analytic work that expatriate advisors are regularly asked to prepare.

All of this suggests that it may be time to review existing approaches to technical assistance, perhaps with a view to reduce its numbers and to concentrate it more explicitly on training. We didn't have time to examine this problem in any depth, nor was it part of our mandate to do so. But during our mission we learned of incidents giving unambiguous evidence of a deep malaise among Kenyan staff, especially in the MFP. And there are other signs that technical assistance has been too lavishly dispensed in Kenya, often counterproductively. In the area of cooperative development, for example, a recent study counted over 1,000 man-years of technical assistance to Kenya's cooperatives since the late 1960s. Yet the cooperatives are as weak as ever, and maybe weaker than they were. In the Ministry of Planning from 1977 to 1984 the Canadian Government spent some $25 million on a program to build a project appraisal capacity. Many man-years of advisors and 80 Kenyan M.A.s later, there is not a sign of project evaluation institutional capacity in the MFP. (There are more trained people, of course, but no institutions.)

One approach with which a modest amount of experience has been acquired, and which may be worth expanding, is to restrict technical assistance in certain organizational units to occasional consultant visits plus whatever opportunities for long-term training present themselves. While management may rely heavily on the consultant(s) for operational contributions whenever the individual(s) concerned are present, during their regular periods of absence management's only recourse is to the efforts of local staff. The latter are in turn well aware of

this, and feel a responsibility to produce on issues that cannot await the consultant's return. ESF technical assistance to the MFP's Debt Management Section and Price Control Division has taken this form.

Computerization: Increasing the use of computers is the SAP's second instrument of change. Unfolding experience there reveals a mixture of pluses and minuses similar to those just noted for technical assistance generally.

On the plus side, word processing and data handling are extremely productive innovations. The budget-making process in most LDCs is dominated by the simple mechanics of putting together thousands of line items and adjusting for frequent changes. Data processing by computers is revolutionary in that it vastly simplifies that task; it thereby releases much skilled manpower, previously absorbed at critical times in checking budget figures or similar chores, for more substantive task. The use of computers in other parts of the MFP seems to be spreading. In one afternoon visit we saw computer work going on in the trade division, and in the industry division.

Some writers break microcomputer usage into different categories. For example, it can have "operational," "managerial," and "analytic" implications. Budget making, word processing and list making are operational. Budget monitoring and reports on project status are managerial. Economic and financial analysis of projects, or macroeconomic projections based on regressions, are analytical.[1]

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[1]These distinctions are made by Kenneth L. Kraemer in his critique of Janice Brodman Microcomputer Adoption in Developing Countries: "Old Management Styles and New Information Systems: A Case Study of Microcomputer Adoption in Kenya and in Indonesia", International Development Management Center, Draft Dec. 17, 1984, typescript.

In Kenya microcomputer usage is mainly "operational." Word processing and accounting applications for budget-making are the most important uses. But the foreign-aided project inventory has also been computerized; this is an exercise in list making. Brodman's study found very limited managerial or analytic usage as yet.

In practice microcomputer usage is still imperfect, even in the limited areas where it has been accepted. For example, the inventory of projects, computerized for the first time this year, was wildly off base for the USAID projects, and other donors similarly reported many inaccuracies. But improvement potential is high with the computerized approach. For example, USAID has put its project lists in a form identical to that used by the GOK, thereby making checking much easier.

In her study of the microcomputerization experience in Kenya's MFP, Janice Brodman points out the fragility of the experiment, and the obstacles to institutionalization. She stresses especially the lack of incentives on the part of professional Kenyan staff to use the new tool. The limited number of clerical-level staff who have learned to do word processing and some data processing do so mainly because it may lead to better-paying jobs outside the Government.

Brodman's study also suggests a basic disadvantage of microcomputerization: it widens the effectiveness gap between the technical assistance staff and local professionals. The former are in the vanguard of microcomputerization. They know how to exploit its managerial and, especially, analytic potentials. The Kenyan staff, less familiar with the computer, less well-trained or experienced in technical matters, and without suitable incentives, generally stay away from the

microcomputer. The result is to make the expatriate advisors even more irresistable to senior ministry officials. It also of course exacerbates the resentments and frustrations of junior Kenyan professionals.

Studies. The third instrument of improved analysis and planning is the access to consultants for studies that the SAP has made available. Some important forward steps have resulted.

- The industrial sector studies (levels and patterns of effective protection) have gotten underway after fours years of delay. The grant financing of the SAP was one factor making this possible, since the purported reason for the delay was GOK unwillingness to use loan funds for financing consultants' studies.
- An Internal Debt Reporting System (KIDRES) has been designed. For the time being its coverage is restricted to GOK loans to parastatals. The system is designed to centralize in MFP the negotiation of loan terms; computation of service payments due, with penalty of interest being applied to arrears; issuance of standardized invoices; and pursuit of defaulting entities. Two successive Budget speeches have committed the GOK to implementing the system, which is on the verge of issuing the first invoices for long-standing loans in regard to which the operating ministries concerned display no interest in collecting from their parastatals.
- Continual improvements have been made in an External Debt Reporting System (KEDRES) that was initially designed and implemented by a current ESF consultant (Clive Gray) at a time when he was provided by UNDP/IBRD. During the ESF phase the system's computer tapes have been accepted for purposes of fulfilling Kenya's debt reporting requirement to the IBRD's External Debt Division.
- A report on the proposed Monopolies and Prices Commission was financed and completed in late 1983. No action has followed, though the report is said to be under active consideration.

4.1.4 Quality of Dialogue

Dialogue among AID Mission staff, Embassy staff and GOK

authorities has been limited in this program area. USAID staff input has been mainly via discussions over consultant activities and studies to be financed. There has, however, been dialogue of unusually high quality inside the Ministry of Agriculture, between TAP and Kenyan staff.

The TAP advisors in the MOA had come up against some fundamental institutional barriers to better agricultural performance, not least of which was the fact that funding for agricultural projects was slow and uncertain, and nobody really knew how the budget system worked in practice. They decided therefore to look closely at budgeting and financial management within the MOA--essentially how money reaches projects. An experienced budget advisor (W. B. Cutter) did a study of the existing (1981) process, and in January 1982 the Ministry agreed to set up a joint TAP/GOK Task Force on Budgeting. The objective was for the Task Force to meet periodically (every three months) for two years, to review experience and problems at each of the various stages of the budget and expenditure process. The members of the Task Force were key budget, technical and administrative staff from MOALD, MFP, and a few others. The number of people involved in each meeting averaged about 50. The quarterly meetings were a day or two days long. Papers were prepared, reviewing problems, experience and possible solutions. Kenyan participation has been extensive, and many recommendations for change have come from Kenyan staff.

Most recommendations remain unimplemented, and the Task Force has hardly produced a revolution in budgeting. But it has led to much wider understanding of the issues and a broader sense of Kenyan participation. The experience has been sufficiently positive to have induced the Ministry of Finance and Planning to undertake a similar exercise.

The project output of "improved analysis, planning, budgeting...in the Ministry of Finance and Planning" has not generated "dialogue" in the same sense as the TAP "Task Force" effort in the MOALD, just described. It has mainly involved extension of computer use in the MFP, and training. It is therefore more appropriately considered separately.

Of course improved dialogue does not necessarily mean more and better reforms. In the case of institutional reforms, especially, short-run effects may be slight. Some insight into the process of reform and the problems of budgeting can be found in the minutes of the MOALD's Task Force on Budget and Financial Management Fifth Workshop (January 26-27, 1984). The review of action taken on previous recommendations notes the following.

- The Task Force had recommended the development of a "Management Calendar" that would set out the timetable for preparation of the forward budget, draft and revised estimates, etc. A calendar had been prepared, but not formally approved and circulated.

- The Task Force had recommended in 1983 that clearer procedures be set down for collection and accounting of appropriations-in-aid (AIAs). Some new procedures have been established, but no monitoring of actual AIA collections; nor has there been any follow-up action on AIA holders not sending monthly returns for AIA collections.

- The Task Force recommended that proposals be prepared to improve the present procedures for submission of claims for reimbursement on externally-aided projects. Some steps were taken, but the Ministry continues to have many problems with these submissions. And although a detailed monitoring system was suggested in a paper discussed in earlier meetings, no action was taken. The following problems were mentioned: the Ministry still has no information on the amount of claims due at any given moment; there is no way to distinguish past claims (arrears) from the present year's claims--the external aid section has not computed the relevant information; no

periodic reporting is made to senior officials on the magnitude of pending claims. (By April 1985, according to several sources, some of these problems had diminished, and reimbursement claims were said to be processed more promptly. We had no way to check this.)

- The previous meeting had recommended that the Ministry establish internal priorities among its program/projects and sub-sectors that are competing for available resources. No action had been taken. An opportunity arose when the Treasury asked for forward budget proposals, but according to the minutes "the short time frame and the preoccupation of the Ministries in developing reports on implementation of district focus policy prevented an analysis of priorities."

- The last meeting had recommended the establishment of a project management system for identification, appraisal, funding and monitoring development projects and programs. The former ministers had approved such a system and included it in a report to the President. But implementation was delayed by the merger of the ministries (Finance and Planning). The system had still not been implemented as of April 1985.

- The Task Force recommended that budget requirements of parastatals be systematically reviewed, and files on them built up. No action has been taken on the proposal. The July 1983 Treasury Circular calling for forward budget submissions giving parastatal investment plans and financial projections was not complied with, due to lack of time.

- The Task Force recommended the establishment of an up-to-date vehicle inventory. Such an inventory was created and put on microprocessors between September and November 1983. But after one report was produced it was clear that changes were necessary. Stations were reporting on four different forms (at least), all inadequate for the purposes at hand; and there was no interest in this reform, except in the Management Systems Unit of the Ministry. A new form was designed and an attempt made to get senior management involvement. But the new forms were not sent to the field and the entire exercise stalled, with no inventory reports being issued. (It appears that this was still the situation in April 1985.)

There were other recommendations, and similar patterns of response. But those just described give an adequate sense of

the process and substance of the dialogue. They also indicate much about the general problem of budget reform.

4.1.5 Quality of the Reform Proposals and Fulfillment of Conditionality

The area of institutional or administrative reform is not well-suited for conditionality. It is rarely possible, first of all, to find good indicators that allow measurement of progress, and hence allow monitoring of proposed reforms. Thus the GOK agreed in June 1983 "to develop a plan to ensure that scarce budget resources are allocated to high priority investments..." and "to establish a special mechanism to manage planning, budgeting, monitoring and implementation of externally financed development programs...." The Letter of Implementation asked only for a letter from the MFP "containing assurances that the decision has been made that new investments in the public sector will be reviewed...and approved in accordance with an investment plan and an external borrowing plan...." The MFP replied in a formal letter by referring to its forward budget and to upcoming World Bank technical assistance to review its investment program. The 1984 agreement has one pertinent covenant: the inclusion of the development budgets of all 25 major parastatal bodies in the Budget Estimates of 1985/86.

It cannot be denied that the GOK has either complied or tried to comply with these conditions. The forward budget does have some claim to be the government's review process for new investments. And in 1984 the MFP did try to bring the parastatals more fully into the budget process. But the forward budget process remains extremely weak, and the 1984 effort vis-a-vis parastatals has failed to produce satisfactory results.

The "compendium" of foreign-aided development projects is used by USAID as the gauge of compliance with the condition that the GOK establish "a special mechanism" for control of donor projects. The compendium is not new: compendiums have been produced since the mid-1970s by the UNDP. A more comprehensive project compendium is now produced by the MFP. But, as noted above, the compendium is inaccurate to an important extent, and in any case it is stretching things to call it "a special mechanism" to manage the "planning, budgeting, monitoring and implementation" of donor projects. But the compendium certainly aims in that direction, and thus surface compliance with the conditions has been achieved.

The meaningfulness of all these indicators is limited. The condition calling for analysis and control of new investments and better budgeting is satisfied by a letter referring to the forward budget, or by the ongoing work on the compendium of projects. Simple issuance of a Treasury Circular would provide enough "evidence" to satisfy the condition on integrating parastatal budgeting--though in fact the GOK effort was more serious than that.

The difficulty of finding meaningful performance indicators for institutional reforms means that they cannot be satisfactorily evaluated. The general objectives (or conditions) are necessarily framed in "process" terms; they call on the GOK to "improve," "undertake," "establish," or "design" something. How well this is being done, or even whether it is being done, is almost always a subjective matter, a matter of judgement. If the evaluator wants to see progress he can undoubtedly find it. If he is looking for foot-dragging or non-compliance he can see that too.

In the SAP, USAID has tried to find more concrete indicators of performance, to deal in some measure with this problem. Thus the compendium preparation (and improvement) is taken in the Quarterly Project Review as an indicator of performance in establishing the "mechanism" for control of donor projects. It has obvious inadequacies in that regard. But the idea is OK, so long as it does not encourage trivialization of the compliance problem.

Similarly, the 1984 covenant calling for continued refinement of the budget process is translated in the Quarterly Review by a single objective: improving budgeting with microcomputers, that is, extending use of microcomputers. Once again, this is an understandable effort to develop some measurable indicator of performance. But the gap between introducing a few additional microcomputers and accompanying technical assistance, and the objective of improved budgeting is so vast that the conditionality aspect is rendered meaningless.

None of this need be particularly troublesome, though it can give rise to misunderstandings. Thus, for example, the Regional Inspector General's Audit of the SAP is critical of GOK compliance with the covenants on review of new investments on the ground that the public sector investment plan (forward budget) that was produced "still leaves a lot to be desired." (Actually, the audit quotes "USAID officials" to this effect.) But the covenant did not say anything about the quality of the investment review, nor indeed would there be much point in doing so, as will be pointed out below. The point is that the Inspector General's Audit made one subjective judgement about compliance with these "process" conditions. Another observer's judgement could easily be more positive.

The difficulty of defining specific and monitorable criteria for evaluating performance on institutional reform is one reason why they are unsuitable for conditionality. There is another reason. Governments hesitate to introduce these kinds of reforms, or do it poorly, not primarily because of lack of will, but because of lack of capacity, and the latter is more related to the condition of underdevelopment than to political/bureaucratic resistance or related obstacles. Thus the GOK finds it difficult to seize effective control over expenditure commitments not because the authorities are against it but because many fundamental attributes of underdeveloped status prevent it: the major role of external players--many autonomous donors for example, with separate agendas and much money; the lack of information and sparsity of analysis; the blocks to information flow between ministries; the scarcity of trained staff; inadequate filing and record-keeping systems; the weakness of project screening procedures and of the agencies responsible for setting priorities.

Finally, effective dialogue over institutional reform issues of the type being considered here is especially dependent on the right conditions--plenty of time, studies to determine appropriate institutional changes, awareness by the outside parties of the intractability of many of these problems, willingness to experiment and adapt. All of this implies the existence of a cooperative effort, undertaken in an atmosphere of mutual understanding and sympathy, with open exchange of ideas, joint exploration of options, measured debate. What is not needed, and is in fact more likely to be counterproductive than helpful, is a contentious setting, such as may be created when dialogue evolves in the context of a conditional loan agreement. These issues are best considered over a longer time period, in a noncontentious setting, with

maximum scope for substantive discussion. The dialogue in institutional matters should entail a truly joint search for appropriate solutions, with a minimum of game-playing. These are not the conditions provided in an SAP framework.

4.2 Reduced Government Participation in Parastatal Organizations

The June 1983 Agreement, Covenant (f), states that the GOK agrees "to undertake a program to reduce the Government's participation in public enterprises as recommended by the July 1982 Ndegwa Report, Report and Recommendations of the Working Party on Government Expenditures." The 1984 ESF Amendment does not refer to this condition.

The 1982 Ndegwa Report made some strong arguments for divestiture.

- It underscored the poor earnings record of most parastatals. For LK 900 million (current) in investments and loan guarantees, only six parastatals (in 1978/9) paid any dividends at all to the Exchequer, and this amounted only to about LK 2 million. Money-losers were numerous. Perhaps LK 200 million will have to be written off or absorbed into the public debt.[1]

- It pointed out that most parastatal investment came about through private sector initiatives; investors sought government partnership so they could benefit from government protection and bail-outs, if needed. And they have been needed, often.

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[1]The values were originally stated in terms of Kenyan pounds. Two values have been converted on the basis of 20 shillings to the pound and 14 shillings to the U.S. dollar (approximately the average exchange rate between 1983 and 1984).

- Government managerial resources were also unduly absorbed by the parastatal sector. Government would be better off if it did "...more of what it does well and less of what past experience shows others can do better...."

- The Report recommended enactment of a State Corporations Act to allow better supervision of parastatals' growth and activities. It also recommended the creation of a Task Force on Divestiture, supervised by a Parastatal Advisory Committee located in the Office of the President.

These structures were set up quickly. The nine-member Parastatal Advisory Committee (five government spokesmen, four private sector) advises on policies toward parastatals including restructuring proposals, reviews proposals to set up new enterprises, and also reviews divestiture projects.

The Task Force on Divestiture started its work in June 1983.[1] It was given a 4-6 person secretariat which spent much of its first months putting together the basic facts on the sector.[2] Their staff identified, for example, 235

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[1]The member of the Task Force on Divestiture of Government Investment are: Chairman: G. H. Harding; Secretary: Dr. M. N. Dangana, Deputy Secretary, Ministry of Finance; Members: S. K. Mbugua, Inspectorate of Statutory Board; T. C. Ramtu, Chairman Industrial Promotion Services; Dr. N. D. Nzomo, Chairman Industrial Development Bank; Professor W. A. Mwangi, Professor Dept. of Economics, University of Nairobi; P. Chege, Senior Civil Servant, Office of the President and T. D. Owuor, Trade Unionist.

[2]The secretariate consists (April 1985) of the following members: Chairman: R. M. N. Danagana, Deputy Secretary, Ministry of Finance; Secretary: K. A. Ateino, Principal Industrial Development Officer, Ministry of Commerce and Industry; Members: Professor T. C. I. Ryan, Director of Planning; H. Mule, P. S. Ministry of Finance and Planning; Professor A. Mwangi, Dept. of Economics, University of Nairobi and E. M. Kisombe, Inspectorate of Statutory Board. (Mr. Mule and Mr. Ryan are usually represented by MFP staff members.)

parastatals--69 of them owned 100 percent by the GOK, and 111 with majority GOK ownership. Along with Treasury staff, the Task Force has made various efforts at classification. They have classified the parastatals into "policy" categories: those that are of strategic importance and thus will remain in the public sector; those that are more properly absorbed into Central Government ministries; and those that might be divested. The results of this analysis have not been made public, though a draft report was submitted in mid-1984.

According to informal sources, the Task Force considered the following companies as good candidates for sale to the private sector. It made a few moves to begin divestiture, but these were stymied, as explained below.

The Task Force has identified some 15-20 enterprises as "easily divestible." Most of these are profitable; five are listed on the Nairobi Stock Exchange. Sale of shares would be manageable, despite Kenya's very thin capital market. (Pension funds form one potential set of buyers; their investment portfolios are presently limited to a narrow range of assets--mostly T-Bills). According to one observer, the textile industry could be divested, after restructuring, and tourism and insurance (since the Parliament has recently passed an adequate insurance law) are other candidates, along with part of Government's holdings in commercial banks. (No obvious national purpose is served by its retention of 100 percent Government ownership of the Kenya Commercial Bank.)

Government policy remains as it was defined in the 1982 Ndegwa Report. It is committed to passing a State Corporations Act that will pave the way for better supervision of parastatals and facilitate possible divestitures. The Task

Force on Divestiture terms of reference remain concentrated on divestiture, rather than on the overall parastatal sector problem.

The parastatal issue has not been important in other donor conditionality.[1] The two World Bank SALs touched it only lightly, as did the IMF in its 1983 SBA. Divestiture as such has been significant only in the USAID program. It has been the subject of some dialogue.

- USAID staff raised frequent questions about divestiture in the periodic meetings with Permanent Secretary Mule of the Ministry of Finance. At one session, in fact, Mr. Mule suggested, presumably in jest, that the U.S. administration seemed to be mainly interested in divestiture and not in better performance of the parastatals.

- Two visitors with interest in divestiture issues spoke with GOK officials in 1984 - Tom Craig and L. Gray Cowan.

Since early 1984, however, the files contain no reference to further discussions.

4.3 Assessment

4.3.1 Significance

Reform of the parastatal sector is a high priority issue. The sector grew rapidly in the past 15 years, and now accounts for almost 15 percent of GDP, 25 percent of fixed capital

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[1]The Feb. 1983 IMF stand-by had in the Letter of Intent, one reference to parastatal reform: that the State Corporation Act be approved by Cabinet before June 1983. But this was not done, or at least the Act was not submitted to Parliament. The Fund explained this failure by the need to take account of the great variability in the legal status of the SOEs.

Table 4.1. Possible Candidates for Privatization

Name of Company	Government Share: Majority (percent)	Government Share: Minority (percent)	General Profitability: Loss	General Profitability: Profit
Cotton & Lint Marketing Bd.	100		X	
Uplands Bacon Factory	100		X	
African Diatomite Industry	100		X	
N.A. Chemical Fertilizer	100		X	
Kenatco Transport	97		X	
Kenya Wine Agencies	75			X
Zimmermens	57		X	
African Tours & Hotels	53		X	
Kenya Molasses	50		X	
Air Kenya		45	Marginal	
Kisumu Cotton Mills		43	X	
Grindlays Bank International		40		X
Crop Protection Chemicals		37	X	
Union Carbide		35		X
Eslon Plastic of Kenya		27	X	
Booth Manufacturers		23	X	
Hill Products		12		X
Tourist Promotion Services		12		X
Nakulines		6	X	

formation, a significant share of total wage employment. The large volume of national resources engaged in the sector is inefficiently used (with some notable exceptions), and control of spending, especially investment, has been highly imperfect. Relatively large efficiency gains therefore seem possible in this sector, which could mean high dividends in terms of growth.

4.3.2 Quality of the Dialogue

The dialogue consisted mainly of occasional exchanges between Mission staff and senior officials. The discussion was on a general level, judging from the record in the files. Technical and political issues were not raised--again, according to the imperfect judgments possible from reading the files. No technical assistance was provided in this area.

4.3.3 Fulfillment of Conditionality

In a formal sense it is possible to argue that the conditionality has been fulfilled. The language of the covenant after all asked only that the GOK "undertake a program to reduce the Government's participation in public enterprises...." The GOK satisfied this condition by setting up the Parastatal Advisory Committee and the Task Force on Divestiture.

The reality of course is otherwise. Very little divestiture has taken place in Kenya. No example of privatization is at hand. Such initiatives as have been undertaken have been stifled. For example, according to some reports, the Parastatal Advisory Committee developed a proposal for the sale of the Cotton Lint Manufacturing Board. But a week after this proposal surfaced, the President made a public statement urging the Board to expand so as to better serve the population. The result was withdrawal of the proposal for sale.

The GOK is even more reluctant to see the liquidation of any parastatals. The Kenatco story is indicative. This large transport firm went into receivership early in 1984. On July 14, the receivers advertised that Kenatco's assets were for sale (80 Mercedes taxis and 93 trucks, 30 service vehicles, and about 17 acres of property with building). On July 17 the Minister of Commerce announced that Kenatco would not be sold: "...Kenatco will not be disposed of as advertised. The issue of employees being laid off does not arise. The Government feels Kenatco being such an important flag and transport carrier for Kenya, steps should be taken to stop it from being sold...."[1]

An analysis of receivership data suggest that the GOK has frequently responded to the possibility of closure or liquidation by arranging bail-outs. This can be seen in Table 4.2. Only eight parastatals have been liquidated in the past decade, and almost all of these have been small, with Government holding a minority position.

Kenya Fisheries, for example, went into receivership in February 1984; in September the GOK intervened to save it. The textile firm Mountex in Nanyuki was put into receivership in 1984 by one of its major creditors, Bank of America. But the GOK asked the Commercial Bank of Kenya to take over the loan in question and prevent sale of assets. The KCB also made available additional working capital.

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[1]The Nation (Nairobi) July 17, 1984. The Minister communicated this ruling to the National Bank of Kenya, (government-owned) whose request for payment led to Kenacto being in receivership.

Non-viable parastatals in the industrial sector have been sustained for many years--for example Kenya Fiber Company and Kisumu Cotton Mills. The latter was rescued from receivership six months ago. And it is the same in other sectors. In 1984 the Kenya Tourism Development Corporation bailed out the tourism parastatal Africa Tours and Hotels (ATH) with a small addition to its equity (5 million Ksh.) The ATH has 13 hotels, of which four are money-losers. The economic rationale for their continued presence in the tourism industry is dubious: they have only four percent of the beds in the hotel industry, and there are many potential buyers of their facilities and/or shares (they are a listed company). But because of bureaucratic resistance, fears of disemployment, and the prevalence of the idea that the parastatal operation increases domestic value added in tourism ("keeps more of tourism's foreign exchange earnings at home"), privatization of this eminently privatizable activity is highly unlikely unless the costs of the present arrangements become both more burdensome and more transparent.

Table 4.2. Companies Under Receivership, 1974-1984[a]

Year	Total	Public Sector	Outcome
1974	11	0	
1975	15	1[a]	liquidated
1976	9	0	
1977	14	1[b]	liquidated
1978	21	2[c]	1 bail-out, 1 liquidated
1979	20	0	
1980	28	4[d]	1 bail-out, 3 liquidated
1981	29	2[e]	2 bail-out
1982	38	3[f]	1 bail-out, 2 transformed
1983	53	2[g]	2 bail-outs
1984	36	3[h]	2 liquidated, 1 pending
1985 (4 months)	8		

[a]About 10 receiverships were not properly recorded in the Receiver-General's files at the High Court, from which these data come. Several of these were public sector.

[b]Tourist Cabs, a subcontractor of Kenatco, which was unable to repay Kenatco credits.

[c]East Airways, an East African Community operation.

[d]The Ken Ren Chemical Company, a fertilizer factory in Mombasa, was liquidated. Simbarite Co., a small building materials operation, was bailed out.

[e]The Tea Research Institute, an EAC unit, was liquidated as was Kenya Fibre Co., and Nakulimes, a clearing and forwarding agent with six percent Government equity. African Retail Traders, with 51 percent GOK equity was bailed out.

[f]Kenya Freight, a Kenya Airway subsidiary was bailed out, as was African Retail Traders for the second time.

[g]Kenya Oil Co., a joint venture between Mobil Oil and GOK, was liquidated as a marketer, and transferred into a fully government-owned exploration agency. Kisumu Cotton Mills, a large factory (2,000 employees) was bailed out by government. Kenya Extel Communication was merged with Kenya Post Office.

[h]Yuken Textiles, a finished goods producer with 200-odd employees, was bailed out. Kenatco is still in receivership, but functioning.

[i]Paperware Ltd. (100 employees) was liquidated; Kenya Chemical and Food Corp. (49 percent GOK equity) is the large molasses/gasohol operation in Kisumu. Cost overruns (250 million starting estimate Ksh.1.0 billion actual) led to closure. It has not been formally liquidated because no buyer has been found. The Rural-Urban Credit Corp. has been closed.

Responsible observers now believe that the strategy of parastatal réform adopted by the GOK after the 1982 Ndegwa Report was ill-designed. Rather than starting with assessments of the whole parastatal sector, the divestiture effort might have more to show if it had focused on loss-making, non-strategic enterprises and activities. Restructuring of Kenya Airways, with concentration on domestic and regional service, is one example; the closing down of passenger service on East African Railway is another.

In any event, divestiture as such is not a suitable area of conditionality for a bilateral donor. There are few opportunities for sale to private parties, except for reduction of public sector-held shares. In the manufacturing sector, the most troublesome enterprises are those that should never have been established in the first place. They can only be privatized by drastic writing down of asset values--an accounting phenomenon that translates politically into: "give-away of national property."[1] This may be--indeed is--

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[1]When bids were sought on the Kisumu Molasses factory, now in receivership, the highest offer was 50 million Ksh. The cost of the plant and equipment was one billion Ksh (including government-guaranteed debt).

necessary, but it is not a particularly attractive act for donors to be associated with.

Judging from its recent behavior, the GOK is clearly unwilling to confront the political risks involved in divestiture of SOEs--notably massive write-offs of national assets, increased unemployment and regional discontent. Kenya also has a special problem of finding suitable owners for any privatized state enterprises. Foreigners are ruled out. Sales to Kenya Asians are also unacceptable. And among potential African purchasers, Kikuyu are in the great majority. So ethnic tensions could be exacerbated by a serious effort at divestiture.

Even the often-recommended first step--privatization of management through management contracts--has not fared well in Kenya. The experiences with such contracts in the textile and sugar industries have been almost uniformly bad. According to one official, only two of eight management contracts in the sugar industry have been satisfactory.[1] Lack of expertise in selection and monitoring is one reason for this; politicization of the process is another.

For these and other reasons, the U.S. would do well to step back from the divestiture question, at least for a while. The Report of the Task Force on Divestiture, when it comes out, may provide some new opportunities. The World Bank has considered

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[1]A few years ago, the World Bank funded trips to Kenya for Ivory Coast sugar industry officials, to show them the management contract arrangements prevailing here, for possible adoption in the Ivory Coast. The Ivorians had very negative reactions and returned home favoring full privatization, not management contracts.

a public sector rehabilitation project in its planning for Kenya, and that too, if it happens, may provide opportunities for new AID approaches. The best long term approach to the parastatal issue will in any event be first of all encouragement of competition, particularly by private domestic producers or providers of services; and secondly, by continuing fiscal and credit constraints that will eventually shut off support to non-viable and low priority parastatals.

4.4 Increased Reliance on the Private Sector to Achieve Development Objectives

Many different components of the SAP touch this output: reduction of restrictions on imports; encouragement of exports (incentives, appropriate exchange rates); investment encouragement (IAPC); liberalization of maize marketing; divestiture of state-owned enterprises; liberalization of fertilizer marketing; reduction of price control obstacles to efficient enterprise operations; earmarking of ESF counterpart for private sector projects.

As narrowly defined in the SAP, and interpreted in the quarterly monitoring documents, private sector encouragement refers only to two policy targets: the formation of a Commission on Monopolies and Prices, and the earmarking of $5 million in counterpart funds for private sector projects.

Thus, the June 1983 agreement has the following covenant on price control policies. It stipulates that the GOK agrees:

> To establish a Monopolies and Prices Commission which will review commercial practices will impose sanctions for practices in restraint of fair trade and will review the necessity for price controls on items for

> which there is determined to be sufficient internal and external competition in the Kenya market, giving top priority to consideration of if the price of fertilizers....

The stimulation of the private sector is obviously an appropriate area for U.S. concern, and amenable to explicit conditionality. More effective mobilization of private sector energies is one of the major potential sources of faster growth and structural change. Both of the specific items in the SAP seem well-targeted. Price controls are a major inhibiting factor not only to the private sector but to all economic agents. And the notion of earmarking counterpart for private projects has numerous advantages, one of them being the direct stimulus it can provide to private alternatives in production of goods and services.

GOK compliance on these matters has been mixed. A study of the monopolies and prices issue was financed by SAP funds, and completed in late 1983. Since then nothing has happened, though the issue is still alive within the Kenyan Government, according to MFP officials. As for the $5 million earmarking for private projects, it remains stalled, presumably for technical reasons related to creation of appropriate mechanisms for implementation.

Except for greater ease of imports (due to reduced balance of payments pressures after 1983), the record of pro-private sector actions shows little to cheer about. Divestiture of state enterprises has proved a non-starter. The maize marketing picture remains clouded. Export and investment promotion is almost non-existent. The only bright spot is the liberalization that has begun in fertilizer distribution.

The objective indicators reflect this lack of progress, this passive policy toward private agents. Manufacturing

production (private and public) grew at 3-5 percent a year between 1980 and 1983, which is about a third of its earlier rate. And unofficial sampling indicates a declining rate of investment and shrinking foreign investor interest in Kenya. An unofficial survey of U.S. investment indicates that in the three-year period 1982 through 1984, there has been substantially more disinvestment than investment. Only two significant investments by U.S. firms occurred during these years, both in agribusiness, and representing for the most part reinvestment of locally-generated profits. Meanwhile between 15 and 20 U.S. firms withdrew during this same period, almost all of these being sales and distribution offices. While much of this springs from the negative world economic environment of the early 1980s, it also says something about Kenyan policies and Kenya's investment "climate," something significant for policy-makers to consider.

5. POPULATION POLICY REFORM

5.1 Introduction

In 1984 Kenya had an estimated population of 20 million people with an annual growth rate of approximately 4 percent and an average completed family size of eight children. This means a doubling time of less than 18 years. Further, it has resulted in what is perhaps the highest child-to-adult dependency ratio in the world, meaning that over one half of the population is under the age of fifteen. Thus, requirements for social services such as schools, health services, and housing, as well as for employment opportunities, food, and water all are escalating beyond apparent GOK capacity to keep pace. Most fundamentally, such trends bring into question the ability of the economy to improve the standard of living for the majority of citizens and to provide rising per capita income levels. This is made even more critical in light of the experience with growth rate of per capita GDP in the past. During the 1964 to 1972 period per capita GDP grew at an average annual rate of 2.7 percent, while during the period 1972 to 1981 the rate slowed to 0.6 percent. Most recently, during the world recession GDP per capita in Kenya declined by 0.4 percent in 1981/82 and recovered to just 0.1 percent in 1982/83.

The rapid increase in population and resulting dependency ratios can be seen in the following data:

Table 5.1. Total Population, Population of Working Age and Dependency Ratios (millions and ratios)

	1964	1972	1981
Total Population	9.1	12.1	16.5
Population of Working Age (15-59 years)	4.5	5.6	7.8
Labor Force (85 Percent of Population of Working Age)	3.8	4.7	6.6
Dependency Ratio (dependents = population - population of working age)	1.04:1	1.17:1	1.3:1
Dependency Ratio (dependents = population - labour force)	1.40:1	1.56:1	1.50:1

(Source: GOK, Fifth Development Plan)

Government attention to rapid population growth in Kenya has only very recently been elevated to a position of serious concern which is warranted by the impacts it has and will increasingly have on the structure of the economy and on all aspects of the society. Indeed, it is fair to say that this explosive population growth rate, perhaps as high as any in the world, still is not perceived as a structural problem. The impacts of such growth in population have, for a decade, been viewed as part of the host of problems to be addressed by development efforts and strategies. But recognition by Government that aggressive policies and programs to reduce the population growth rate are at the center of any effective effort to restructure the economy to make it more sustainable in future years is only now beginning to occur. Such concern must rapidly be moved to the forefront of policy strategies.

5.2 The Government's Stated Approach to Addressing Structural Problems of Population

Effective action focused on reducing rapid population growth rates in Kenya is a recent occurrence on the part of

Government. The Fourth Development Plan (1979-1983) had as a theme alleviation of poverty through emphasis on stimulation of growth; higher household incomes which were to be created through additional income-earning opportunities; improved Government social services; and an improved income distribution in the country. Nowhere in this strategy statement is there explicit recognition of the drastic impacts which Kenya's explosive population growth rate has on economic structure and the level and distribution of poverty.

Even in the section on population within the Chapter entitled "The Policy Framework", the GOK expressed a relatively passive attitude towards population growth:

> In Kenya decisions on family size rest with parents. These decisions, taken together, determine the rate of population growth in the nation. While the Government is concerned about the very rapid rate of population growth in in Kenya, it is also convinced that as these concerns come to be understood in terms of effects on family welfare and the quality of life, parents will adjust their decisions in favor of smaller families.

And yet the Fourth Plan projected a reduction in the birth rate during the planning period, to be followed by a reduction in the rate of population growth, estimated in the plan document at 3.5 percent in 1979, which would have a noticeable impact by the end of the century.

Government recognition that rapid population growth represented one of the most serious structural imbalances in the economy was also basically absent in Sessional Paper No. 4 of 1980 on Economic Prospects and Policies (which in reality was a mid-Plan revision of targets and strategy for the Fourth Plan) and in Sessional Paper No. 4 of 1982 on Development Prospects and Policies.

The Fifth Development Plan for the period 1984-1988 provided a slightly higher visibility to population growth as an issue and to related strategies for its control. Within a Plan Theme of "mobilizing domestic resources for equitable development" there was recognition that the population growth rate stood at an estimated 3.8 percent between 1969 and 1979, up from an estimated 3.4 percent during the period 1962 to 1969. It further took note of World Bank estimates of Kenya's population growth rate of 4.1 percent in 1979. The strategy articulated in the plan document consisted of the following:

> Population Policy, Strategy and Programme--Since the rate of population growth is mainly determined by decisions taken by parents on family size, during this Plan period Government, in co-operation with non-Government organizations will intensify its programme of informing and educating actual and potential parents regarding the benefits of smaller family sizes particularly since the fertility of less educated women is found to be higher. Family planning services will be made available mainly in the rural areas, by increasing the number of health facilities offering family planning services and also the number of trained personnel to provide these services.

Building upon the Maternal Child Health/Family Planning Programme launched in 1967, the GOK announced in the Fifth Plan the intention to centralize population policy development in the National Council for Population and Development within the Office of the Vice-President and ministry of Home Affairs. Population policy goals were to be set by the Council to guide the Integrated Rural Health and Family Planning programme established by the GOK in mid-1982. This latter programme is a six year effort dealing with Rural Health and Family Planning as one component and Population Information and Education in another component.

Only in the 1984 Cabinet-approved "Population Guidelines Policy Paper" scheduled to be sent to Parliament for review

during 1985 did the GOK incorporate a concern for dealing with the population growth problem as a central part of structural reform. This draft Sessional Paper adopted a goal of 3.5 percent growth rate of population by 1988.

The link of population to economic growth and structural change is perhaps best recognized by the GOK in the Statement By the Minister For Finance and Planning to the Donors' Conference in Nairobi on March 21-22, 1985:

> . . . time is not our friend. While the economy has limped along, growing at four percent a year from 1979 to 1983, population growth has accelerated close to four percent a year. The Government and, indeed, the leadership of the nation has become increasingly concerned and is determined to reduce population growth. But it takes time to make measurable progress against so fundamental a problem. What the country needs is some breathing space in the form of rapid income growth--around six percent a year. Such rapid growth is needed over the next 15 years to create jobs for an expanding work force whose members have already been born. A rapid growth is needed to keep incomes growing faster than the population, while National Family Planning takes hold and development itself creates conditions favouring smaller families.

5.3 Donor Policy-Based Conditionality

5.3.1 World Bank Conditionality

As a focus of concern in structural reform agreements, population arises in the World Bank's Second Structural Adjustment Agreement with Kenya. The Letter of Development Policy dated May 11, 1982, recognizes rapid population growth as a critical development issue," endorses the Fourth Development Plan objective of expanding family planning facilities, and states that "results have so far been disappointing" in achievement of Fourth Plan goals. Therefore in the May, 1982 letter, Kenya agreed to launch an expanded

informational and educational campaign and to develop specific targets for family planning acceptors, for average family size and for population growth, all to be incorporated in a then planned second rural health and family planning project.

5.3.2 AID Conditionality

The 1984 ESF Commodity Import Grant Agreement for Structural Adjustment signed September 25, 1984, contained a Condition Precedent regarding family planning:

> Evidence that the Government of Kenya shall waive all import duties and eliminate taxes on comodities used for family planning services. A public announcement to this effect will be made by the end of October, 1984 in the Official Gazette.

The GOK responded to this on January 11, 1985 by providing a copy of the Gazette notice carrying out this requirement which took legal effect on November 14, 1984. In the scope of traditional structural reform inherent in ESF Grants, population virtually does not arise as a structural issue. Despite the brief and very focused Condition Precedent in the 1984 Agreement, no real attention has been paid to the structural nature of population growth.

5.4 Future Approaches to ESF Conditionality and Related Technical Assistance

AID in Kenya has supported a number of projects related to health and family planning. These include participation along with other donors in the Integrated Rural Health and Family Planning Project (with AID's contribution coming under its Family Planning II project), a Family Planning Private Sector Project and a Population Studies Research Project which ended in 1984 and a large number of innovative activities funded under AID/Washington grants.

A major new initiative by AID is a planned Family Planning Services and Support Project (project # 615-0232) for which a PID has been approved. This project intends to expand public access to quality fertility regulation methods and greatly strengthen the capacities of the National Council for Population and Development through a grant of US $35 million over seven years beginning in fiscal year 1985. Fertility regulation services have thus far entered the ESF Grant Agreements almost as an aside; the 1984 ESF Agreement was used as a means of assuring that Government would comply with a Condition Precedent related to elimination of tariffs and taxes on family planning materials.

The more basic issue is whether ESF Agreements, which focus on fundamental structural reform, might not have been used more actively in previous years to accelerate action in Kenya on the population growth issue. Of even more direct concern, should ESF Grant Agreements be used in future years to supplement other US AID efforts to bring about constructive change relative to Kenya's population problem? Recent studies demonstrate substantial unmet demand for services in family planning. Thus, strengthened GOK recognition of the problem and commitment to finding solutions, coupled with growing demand for services, make the situation conducive to moving population to a central place in programs of structural reform.

There is no doubt that explosive population growth in Kenya is a structural imbalance which requires reform. Indeed, rapid population growth drives other development needs in the economy and makes progress towards growth of income and well being much more difficult than in the case of slower rates of growth. In retrospect it appears that donors active in policy-based structural reform support should have placed more

concerted attention on the issue and on related policy and institutional reforms.

Excessive pressure and conditionality in the field of population would not appear to be productive or appropriate. However, past attention to the issue in structural reform has been insufficient. Thus, the suggestions made below attempt to strike a balance so that sustainable progress is achieved in attacking the rapid population growth rate in Kenya.

There are two areas where AID programs in future years could relate to population. First, it is suggested that the GOK be asked to adhere to the timely achievement of the Performance Target Indicators in the multi-donor Integrated Rural Health and Family Planning Project. These targets were reached through dialogue between donors and the GOK. The targets represent realistic if ambitious levels of performance which can be monitored for achievement. Furthermore, the targets can be modified in future years through the same process of dialogue between donors and the GOK, so that ESF conditionality would apply to fulfillment of quantitative targets which would be given specificity through a process separate from ESF dialogue.

To meet these agreements, the Kenyan Government will have to place much greater priority on investment in rural primary health care outlets and personnel, through non-governmental organization and/or government facilities. This will likely require less expenditure on curative services, especially through Kenyatta National Hospital which currently takes approximately 40 percent of the Ministry of Health's total recurrent budget.

Related to this possible condition could be a request that the GOK assure full funding for the population activities necessary to fulfill targets set through the Integrated Rural Health and Family Planning Project. Counterpart funds generated from ESF in future years could be allocated by the Kenyan Government to such activities, thus guaranteeing the availability of necessary resources.

6. ACHIEVEMENTS AND DEFICIENCIES OF THE AID STRUCTURAL ADJUSTMENT PROGRAM

The present evaluation involves two related but distinct set of questions. First, how well has the AID SAP program worked? Was it well designed to achieve its objectives? Were the objectives themselves well chosen and were the right instruments used? These are the questions that are given detailed attention in the previous discussion. In this chapter we summarize and systematize the analysis found there.

The second set of questions concerns Kenyan performance. Here the issue is not only whether the GOK complied with the conditionality set out in SAP covenants and conditions precedent (which is also part of the "effectiveness" assessment) but how much "real" reform has gone on, how much movement toward addressing basic structural problems. It is this latter question that has generated the most controversy in Kenya and that has to be considered in any general assessment of AID's (or anybody else's) policy-based loans and grants. We address the real reform question in Chapter 7.

6.1 Unambiguous Achievements of the SAP

6.1.1 Economic Stabilization and Political Objectives Satisfied

In the list of "program outputs" that we are asked to evaluate, two important "outputs" are left unmentioned: the contribution of the SAP to the GOK stabilization program, and its contribution in reinforcing Kenyan-U.S. political ties. The economic stabilization objective was paramount in the first "tranche" of the SAP--the June 1983 ESF Grant. And it should shock no Kenyans nor embarrass any Americans to acknowledge that Kenya is a close friend and important ally of

the U.S., and that the size and quality of the U.S. aid program is related to that fact.

The SAP certainly made a major contribution to the GOK's successful economic stabilization program. For four years, previous to 1983, the GOK had been unable to introduce an effective stabilization program under IMF auspices. The 1983 effort might also have been a failure without the gap-filling $28 million cash grant the U.S. hurriedly made available in June 1983. The ensuing stabilization effort is one of the great stabilization success stories: reduction in the rate of inflation by more than half, from 20 percent per annum in 1980-82, to below 10 percent in 1983 and 1984; reduction in the budget deficit from over 10 percent of GDP in the early 1980s to 4-5 percent in the past two years; a devaluation of perhaps 15 percent in the real effective exchange rate; a sharp reduction in foreign borrowing and in current account deficits.

It is possible that stabilization would have occurred in the absence of an IMF program and the 1983 U.S. support for that program. Kenya has traditionally pursued prudent financial policies, and the risk of economic disorder that threatened in the early 1980s would have had to be addressed at some stage. But the U.S. response made it possible for the GOK to introduce the needed policy adjustments more quickly and less painfully. And it is not unlikely that without the June 1983 grant the IMF program would not have survived and the stabilization effort might have been derailed.

On the political side, relations with the GOK have been cemented by AID's provision of prompt, flexible and large-scale assistance. The U.S. has responded generously to crisis after crisis--economic recession after 1980; the coup

attempt in 1982; the drought in 1984. In several of these perilous years the U.S. has been the biggest donor, and it has been important every year since 1980 (Table 1.2). The GOK has become a close U.S. friend, as is evident by such indicators as U.N. voting behavior and--more important--the openness and cordiality of overall relations between the two Governments.

The SAP has become a significant element in the bundle of mutual commitments that now characterizes U.S.-Kenyan relations. The understandings that link the two countries have many elements of which the aid program--the SAP in particular--is one.

6.1.2 Fertilizer Marketing Liberalization

The SAP has been a major factor in changing GOK policies toward marketing of fertilizers. Private distributors have been given access to a share of fertilizer imported under the program. This is the most significant liberalization move made by the GOK in recent years. Discussions on price policy for fertilizers have led also to a coordination and rationalization of the fertilizer pricing policies adopted by different donors. And the AID program has induced other donors (IBRD notably) to adopt similar approaches.

The program is limited in scope: in April 1985, 12 firms had bank guarantees for 13,000 tons of the 50,000 ton AID program. But there is progress: in 1983 only 7,000 tons had been allocated to five private firms. In 1984, 29 firms bid for access to these imports.

There are also substantial problems with the import program and in the fertilizer sector more generally. The requirement for access to bank credit, for example, limits entry and encourages politicization and patronage-based actions. The

persistence of price controls causes problems. For example the 1984 cif price (based on costs of shipping in U.S. bottoms) was too high to find buyers. The petition for approval of a price reduction took so long that the fertilizer was not available during the planting season. Similarly, on one occasion (in early 1985) a shipment of Dutch Government-provided fertilizer was priced 25-30 percent below the fixed (cif plus official markup) price. The Dutch knew nothing of this, and what happened remains unclear; it apparently involved an effort by the Kenya Grain Growers Cooperative Union to extend its market share. Resulting market disruptions and consequent appeal to the Treasury by the Dutch aid office and competing fertilizer suppliers led to establishment of a "normal" price.

The present arrangements also discourage development of marketing networks and outreach to small holders. Fixed retail prices and brisk demand means that those who get access to imports of fertilizer tend to sell to larger buyers, since marketing costs are minimized that way--a "simple phone call." Nonetheless, progress so far is genuine and potentials for further opening up of the fertilizer pricing and distribution system are substantial.

6.2 Areas of Mixed Results

Economic stabilization, political good will and fertilizer liberalization are examples of clear achievement. In all other aspects of the program the picture is one of mixed success and failure.

6.2.1 Institutional Reform: Better Analysis, Budgeting, and Planning

Some positive achievements are observable in budgeting, planning and the building of capacity in policy analysis.

- The technical assistance provided through TAP undertook numerous policy-focused studies in the MOALD and the MFP (See Annex A).

- The TAP staff in the MOALD took innovative steps to broaden and deepen dialogue on problems of budgeting and financial management. The work of the task force created in 1982 to allow joint reflections on budget reform has been sufficiently fruitful to induce the MFP to start a similar exercise. Concrete results in the MOALD are few as yet; it appears that improvements have been made in speeding up the distribution of budget allocations to spending units and in processing requests for reimbursement from donors for expenses incurred on development projects.

- SAP (ESF) Technical Assistance funds have provided resources for the spread of computerization in the MFP, and related training. This is a breakthrough in the introduction of new data handling and management techniques in Kenya. Demonstration effects are already apparent in other ministries.

- The Technical Assistance Pool/MOALD has intensified efforts to address the institutional development and training aspect of assistance to that ministry. In-service training of a more formal kind has been introduced. This is not only positive in itself, but helpful in screening candidates for overseas training.

- The technical assistance provided to the rural planning unit in the Ministry of Finance and Planning made several unanticipated contributions in addition to their ongoing work: they provided timely assistance in the drought relief effort, and they helped introduce microcomputers in the Ministry, which cannot fail to have long run impact in improving government efficiency. For example, the word processing and simple data processing capacities of the microcomputers make possible simple but substantial improvements in speed and accuracy of budget preparation.

- The compendium of development projects has been improved and computerized. This is the main instrument thus far devised to give Government better control over new project commitments. It was formerly produced by the donors themselves (UNDP). It is now internally produced.

- Preparatory work has been completed to enable the GOK to better monitor internal and external debt (KIDRES and KEDRES).

- Circulars have been drafted and distributed regarding the incorporation of parastatal expenditure programs in the forward budget.

On the other hand, there are sharp limits to many of The MFP and MOALD have received abundant technical assistance over the years, most of it of excellent quality. Yet institutions remain weak, with limited indigenous analytic capacity, and fragile procedures for project generation, control of new expenditure (especially investment) commitments and budgetary/financial management. Senior Kenyan officials have become dependent on the expatriate technical assistants who are generally more experienced and better trained. The result is alienation and withdrawal of effort by many Kenya staff, who feel excluded from most important work in these ministries. The result is the opposite of institution-building; it is institutional atrophy.

- Paradoxically, the broader introduction of microcomputers that is one of the positive effects of the SAP, could very well exacerbate this problem. Technical assistance staff tend to be much more computer-facile than Kenyan staff, increasing their capacity for quick and elegant responses to work requests from senior officials, and widening the gap between them and their Kenyan colleagues.

- The budget improvements are slow in coming and most are shallow. Few of the recommendations of the joint budgeting/financial management task force that has been meeting since 1982 have been adopted. The reform of the forward budget process has been inadequately thought through; among other deficiencies, initial efforts insisted on too much detail. This would have been extremely difficult to implement and of limited meaning anyway, given the uncertain foundation of both revenue projections and expenditure "commitments." The improvement effort may have set back the process, by reducing the already low degree of credibility of the forward budget idea.

- The effort to incorporate major parastatal spending plans in the forward budget fared no better. The 1984 effort yielded unusable results. It is unlikely the 1985 budget will do much better.

- The control of new investment commitments remains as weak as ever. The advance represented by computerization of the compendium of foreign-aided projects is genuine but small. The difference between what the MFP compendium shows and what donor records show is extremely large. Production of an accurate and up to date compendium will require mastery by the MFP of a large and complex system of decision making and program implementation. It is not clear how much closer the MFP is to that mastery now than it was two years ago. Moreover, the compendium is intended to be an aid to better control of project commitments. But there is some evidence that control over new commitments may be weakening rather than growing stronger. The aircraft purchases by Kenya Airways is one indication, and others are in the form of rumors--a new and expensive ($200 million) railway spur for which feasibility studies already exist, and a new cement mill project for example. Costly new grain storage projects, extension of irrigation schemes of doubtful productivity are other examples. Of course no government is entirely economically "rational" in its use of resources, and the GOK has been better than most. But these signs of loosening discipline--if that's what they are--are ominous.

6.2.2 Trade and Industry

As in the World Bank's SALs, a major objective of the SAP is reform of the trade regime aimed at reducing industrial protection and increasing competitiveness. A significant reduction in average tariff levels occurred in the 1983 and 1984 budgets. The volume of imports has increased. Progress has been made in streamlining import administration. Information is more readily available to private importers. The real exchange rate has been devalued, probably by some 15 percent. A major direct contribution of the SAP was in provision of acceptable forms of technical assistance to facilitate key studies. The industrial sector studies (effective protection patterns and levels) have gotten under way after four years of delay. The grant financing of the SAP made this possible.

On the other hand, quantitative restrictions persist. The target of automaticity in approving import license requests has

not been achieved. Little progress has been achieved in facilitating exports. Almost no progress has been made in making the manufacturing sector more efficient by opening up the economy to broader competition from imports.

6.3 Areas of No Achievement

6.3.1 Agricultural Policy

The balance of pluses and minuses leans toward the minus side in agricultural policy. The major failure of the SAP, and the principal cause of the break in World Bank structural adjustment lending, has been in maize marketing. Indeed, except for fertilizers, no liberalization has occurred in agricultural marketing. There was backward movement in 1980, when the National Cereals and Produce Board substituted 300 of its own buying stations for licensed agents. The GOK stated in its sessional paper on National Food Policy (1981) that the long-term goal, as in the Development Plan, was to free the market: to remove restrictions on grain movement and use the NCPB as a buyer and seller of last resort, not a legal monopolist. The GOK reasserted this position in December 1983 discussions with the World Bank, and on that basis the second tranche of SAL II was released. But the GOK has not implemented that agreement.

A number of reasons have been put forward by GOK officials and others to explain the failure to liberalize maize marketing.

- The times have not been propitious for maize market liberalization. Had it been done in 1980 it would have been a political disaster; the price rises and scarcity-induced strains would have put liberalization into disrepute and brought irresistable pressures to reimpose controls. The same would have occurred in 1984.
- Along the same lines, GOK officials insist that the long-term goal remains a liberal marketing system, but

timing will be slower than anticipated. The drought experience has pushed food security considerations to the fore. Liberalization will have to await the building up of an adequate grain reserve.

- Some spokesmen and observers say that donor reformers have given too much emphasis to maize marketing liberalization. According to most estimates, the official marketing channel handles only about 20-30 percent of total marketed maize. The rest is traded in parallel markets, at open market prices. This means that most transactions take place at higher than official prices, so liberalization would have limited price-raising effects. The fact that maize production is estimated to have grown by nearly four percent a year on average since 1980 indicates that the marketing system cannot be a crippling impediment to output growth.

These are serious objections to liberalization, and they are not the only ones that could be raised. But significant negative economic consequences of excessive public sector interventions do exist--for example in increasing instability of prices and accentuating food insecurity in some maize deficit areas. And negative long-term institutional effects are even likelier and more important. The present arrangements hold back the emergence of a class of rural intermediaries who can provide efficient services to rural areas over the long-run.

Also, some anti-liberalization arguments are unconvincing. The argument that a national grain reserve is needed before markets can be liberalized was used in 1980. The bumper crops of 1982 and 1983 did not change things.

Moreover, recent legislative initiatives represent backward steps. The bill on grain marketing (May 1985) now before the Kenyan Parliament incorporates no liberalizing provisions. It is retrograde to the extent that it seems to rule out private trade in even the small volumes (one ton) that can now be moved across district frontiers. Structural reform

in maize marketing, one of the main objectives of the SAP (as of the Bank's SALS), thus seems as far away as ever.

Some other elements of agricultural policy have been more positive. These will be discussed in the assessment of GOK performance in Chapter 7.

6.3.2 Divestiture of Parastatals

Redimensioning the parastatal sector has not occurred. The promising beginnings in the recommendations of the 1982 Ndegwa Commission, and the appointment of two committees, have so far come to nothing. The GOK has exhibited extreme reluctance to sell state assets at prices reflecting their earning power (and not their original investment cost), or to liquidate profit-losing enterprises. While the letter of the SAP covenant has been complied with, its spirit has not.

6.3.3 Population Policy

The GOK has satisfied the covenant in the SAP whereby it agreed to waive all import duties and eliminate taxes on commodities used for family planning services. Other action, and failures to act will be noted below. Here the only other relevant observation is that there has probably been inadequate focus on the family planning issue in the SAP.

6.4 Operational Deficiencies

6.4.1 Conditionality

The analyses in Chapters 2 through 5 lead to the general conclusion that the policy objectives of the SAP are "significant." The "efficiency" aspect was not concentrated directly, that is, whether there might be better ways to achieve the policy objectives. A number of problems in the implementation of the SAP are outlined here.

- There are too many "output" targets in the program; the nine output areas cover too much of the waterfront. This has made monitoring extremely difficult and spread the available USAID staff too thinly.

- The outputs in institutional reform are too diffuse and difficult to monitor. The mission has made gallant, highly ingenious efforts to invent measurable criteria, but the results are unconvincing. For example, USAID's Quarterly Review criteria for implementation of the budget improvement process is the introduction of a few dozen computers in the MFP. There's something to this, but the distance between computer use and budget reform is too vast to make such a criteria meaningful. Besides, it is an extreme example of a tendency to measure progress by reference to inputs, not outputs.

- The conditionality in the SAP is of limited meaningfulness. The covenants and conditions precedent are written in such a way that superficial compliance is common. Implementing letters are more specific, but GOK replies are with few exceptions quite general, involving surface compliance. In addition, as with all conditional assistance, external factors often "excuse" noncompliance and reduce both the likelihood of punitive donor response and the credibility of the implied threat. When world market prices plummet or drought hits, conditionality aimed at structural reform often loses its relevance.

There is another, perhaps more important reason for the dubious credibility of threats to cut commitments because of non-compliance with conditionality provisions. The political realities strongly discourage the transmission of clear signals, of "lessons." The Kenya case is illuminating. The cut in the 1984 ESF program from a planned $40 million to $20 million, and its later replacement by $20 million in PL 480, was recognized by very few Kenyans to be a response to inadequate GOK performance on grain marketing reform. It is not in fact clear that any Kenyan officials understood this. It is also not clear that the reduction in the quality of the SAP, from a cash grant in 1983 to a CIP in 1984, was recognized as a U.S. response to GOK performance failures. In other

words, the link between Kenyan performance and U.S. response is not clearly transmitted and consequently very dimly preceived by GOK officials and political authorities. The main reason is that donor governments do not normally administer partial rebukes to friends and allies and tell them about it openly.

All of which raises the obvious political constraint to the consistent application of conditionality. Given the complexity of the mutual commitments that bind Kenya and the U.S. together, there is a clear limit to the weight that can or should be given to noncompliance on conditions relating to a particular item of policy reform. In a case of clearly bad performance on a fundamental matter (for example, wholesale violation of human rights) the issue might be joined. But it is not plausible to expect that a whole bilateral relationship would be put at risk because of imperfect compliance on a policy reform covenant. This is especially so when the record of performance is not overwhelmingly bad.

Finally, experience in Kenya (and elsewhere) suggests that explicit conditionality tends to generate a great deal of game-playing, to the detriment of true dialogue. Close reading of the files and conversations with many of the players indicates that the following scenario is common. A key GOK official (USAID's point-of-contact) signs the grant (or loan) agreement with its attendant conditionality. Once signed, there is a long silence from the Kenyan side. The U.S. authorities then nag appropriate agencies to comply with the CPs. Usually, after further delay, the contact person finds "acceptable" language that he incorporates in a general letter of response to the Project Implementation letters he has received from the AID Mission. Follow-up is then sporadic--at least according to what's in the files. It is not altogether clear what purposes are served by most of these exchanges.

6.4.2 Policy Dialogue

The discussion of conditionality leads to the question of the quality of dialogue. Dialogue occurs on at least three levels. The first is stratospheric; it is the kind of discussion that takes place at Consultative Group meetings, or meetings of high level U.S. officials and Kenyan counterparts, such as the "bilateral" held last January with Princeton Lyman and others from Washington. The second are talks between Embassy and AID Mission spokesmen and Kenyan authorities. The third unfolds in ministries and involves resident or short-term technical assistance people working and talking with Kenyan counterparts.

The high-level talks can be useful--and often are useful--in clearing the air about larger issues. But they are too cosmic and hence usually too general, are necessarily limited in depth, and are hindered by diplomatic trappings. The setting is too formal, and people tend to speak as official representatives. Moreover, Consultative Group meetings are often regarded as pledging sessions. For all these reasons little real dialogue goes on, except occasionally in the corridors.

The Embassy/USAID exchanges with GOK officials have been too much dominated, in the Kenyan case, by compliance problems. It does appear, however, that the series of monthly meetings in 1984 were unusually far-ranging and frank. Very few Kenyans have participated in these discussions, however. The most intensive policy dialogue should occur, and often does occur, at the technical assistance level. The main question here is whether the dialogue is not too vertical, between a few senior Kenyan officials and expatriate advisors.

Overall, the policy dialogue has not penetrated deeply into technical issues, has involved too few Kenyans and--on the first two levels anyway--has been too frequently contentious and "formal." The exchanges over conditionality items, which could be an occasion for genuine interchange on substantive matters, tend to become exercises in contractual accommodation-i.e., finding wording that is acceptable to all the parties.

7. KENYA GOVERNMENT PERFORMANCE

Success and failure in economic policy reform are blended more dramatically in Kenya than in most countries. This explains the existence of widely divergent assessments of GOK performance. The IMF, and many others, hold up Kenya as one of the rare countries to introduce a stabilization program and stick to it; they also underscore progress in changing the incentive structure in the economy. The World Bank, many in USAID, and many other observers point out with concern that Kenya has failed to address its most basic structural problems and that time is not on its side, not with a four percent rate of growth of population. This dual record of performance is reviewed in this chapter to explain why split judgments are common.

7.1 Positive Steps

The positive steps taken by the GOK since the early 1980s are extensive and impressive. Demand management measures have been very effectively applied. Since 1980-81, the budget deficit to GDP ratio has been cut in half, from over 10 percent to four to five percent. The Kenyan Government's recourse to bank credit has also been much reduced. The rate of inflation fell from 20 percent to about 10 percent, and the current account deficit has fallen from some 10 percent of GDP in 1980 to 3 percent in 1983.

In addition, important transformations have occurred in basic prices. The first point to be made here is that the exchange rate has been devalued. The SDR value of the Kenya shilling has fallen by over 35 percent since 1980. The real adjustment--taking account of relative rates of inflation in

Kenya and in countries with which it trades--is between zero percent and 12 percent (as of mid-January 1985). The difference comes from deflator problems. If the Consumer Price Index is used to derive the real effective exchange rate, then the real devaluation has been 12 percent. If the GDP deflator is used, the devaluation is close to zero. GOK spokesmen argue that the CPI is the proper deflator. In any event, exchange rate management has been good, and the process of gradual adjustment by small devaluations seems to be on the way to becoming institutionalized.

Secondly, several years during which interest rates were lower than the rate of inflation (negative real rates), the GOK has pushed up rates so that by 1983 they became positive. Table 2.1 is repeated below to illustrate the point.

Table 7.1 Interest Rates, 1979-1983

	Commercial Bank 9-12 Month Time Deposit Rates(%)		Commercial Bank Loans and Advances(%)	
Year	Nominal	Real	Nominal	Real
1979	5.63	-5.9	10.0 (min)	-2.0
1980	5.63	-6.4	10.0 (min)	-2.5
1981	6.35	-11.4	11.0 (min)	-7.9
1982	12.25	-4.4	14.0 (max)	-2.9
1983	13.79	3.2	16.0 (max)	5.2

Also, the government has allowed real wages to fall substantially in the 1980s. Table 7.2 shows that after a series of wage increases in 1980 and 1981 (10.5 percent for private sector employees, 8.2 percent for public sector workers), real public sector wages fell by 18.7 percent in 1982 and 4.4 percent in 1983. Civil servants lost 19.8 percent in 1982, 4.6 percent in 1983 and 5.1 percent in 1984. And teachers wages fell by about the same amount.

Table 7.2 Sectoral Real Wages (Ksh./month)[a]

Year	Civilian Govt.	Teachers	Para-statals	Public	Private	Total
1972	925.1	1,013.3	1,151.9	1,010.3	705.7	828.3
1973	902.2	1,085.9	1,233.5	1,042.6	683.6	828.8
1974	879.1	888.2	1,111.1	937.8	669.9	781.6
1975	885.7	723.3	1,126.8	888.3	652.9	754.2
1976	1,063.1	809.2	1,053.8	974.9	729.1	841.8
1977	1,001.1	822.2	1,053.5	954.8	739.3	838.3
1978	977.3	807.0	1,026.4	937.1	726.0	823.5
1979	873.0	802.2	1,101.7	916.7	739.8	822.6
1980	815.9	812.6	1,042.2	874.4	817.5	845.8
1981	944.0	873.3	1,044.5	946.4	803.2	874.4
1982	751.5	706.0	866.4	769.1	684.3	728.1
1983	717.0	668.9	839.1	735.2	662.6	700.5
1984	680.1	N.A.	N.A.	N.A.	N.A.	N.A

[a]Nominal wage deflated by mid-year middle income consumer price index for Nairobi (June 1976 = 100).

Source: J. Nandermoortale, "Wage Trends in the Public Sector in Kenya", ILO, Nairobi, Dec. 1984, mimeo.

Table 7.3 Sectoral Wage Employment 1972-1984

Year	Civilian Govt.	Teachers	Para-statals	Public	Private	Total
1972	108,994	66,757	73,889	249,640	370,696	620,336
1973	99,044	73,697	89,829	262,570	386,791	649,361
1974	102,680	98,917	91,062	292,659	408,892	701,551
1975	111,531	108,234	91,474	311,239	411,442	722,681
1976	122,127	110,303	94,684	327,114	386,523	713,637
1977	125,928	114,857	97,400	338,185	398,091	736,276
1978	134,354	110,372	101,553	346,279	403,696	749,975
1979	159,019	116,148	107,692	382,859	435,249	818,108
1980	163,208	135,162	126,831	425,201	429,580	854,781
1981	179,322	136,300	113,580	429,202	434,127	863,329
1982	194,050	140,389	115,729	450,168	420,930	871,098
1983	206,637	148,042	113,927	468,606	430,157	898,763
1984	210,513	N.A.	N.A.	N.A.	N.A.	N.A.

Source: op. sit.

Employment trends indicate a serious effort to contain propensities for public sector employment expansion. Table 7.3 shows that public sector employment grew much faster than did private in the period since 1972; public employment was 52 percent of total employment in 1983 compared to 40 percent in 1972. The GOK now employs more teachers (a third of total public sector employees as against a little more than a quarter in 1972). The parastatals' share fell from 30 percent to 24 percent over the period. Most of the fall in parastatal employment has occurred since 1980. Civil service employment, which had been the biggest growing component, grew by only 1.9 percent in 1984, which is much below its earlier rate of increase.

The government's record on farm prices is patchy, but better than in most African countries. Real producer prices fell by 1.3 percent annually between 1972 and 1982, but sales were on the rise so income terms of trade (total receipts adjusted for inflation) rose by 2.2 percent a year between 1972 and 1982. So producer real incomes from marketed output rose by about a quarter. Population was up by 40 percent during these years, however, real income per capita from official sales declined.

Prices over most of the period seem to have been close to international prices, even when the shilling is appropriately (shadow) priced. The situation since 1980 is shown in Table 7.4.

Real producer prices thus seem to have declined slightly for maize, wheat and sugar, and a great deal for cotton. But except for cotton, output prices rose more than input prices. And growers of most crops did much better than urban wage earners.

Table 7.4 Increases in Official Producer Prices, 1980-81 to 1984-85

Commodity	Percent Change
Maize	74
Wheat	64
Sugar	66
Cotton	33
Tea (KDTA)	191[a]
Milk	105
	Input and Consumer Price Rises(%)[a]
Purchased Inputs	57
Consumer Goods Rural Areas	82

[a]1983-84
Source: Government of Kenya, "Kenya's Economy 1984-1986", Paper presented to Consultative Group Meeting, January 1985, mimeo, p. 7.

In terms of key prices then, GOK policies in the past five years have certainly been "right," or at least changed in the right direction. It is too much perhaps to call this a transformation in the structure of incentives, since the changes are recent, of relatively small magnitude and fragile. But it is undoubtedly a strong performance, well above par for low-income LDCs.

7.2 Liberalization: Mixed Reviews

The issue of import liberalization is, with grain marketing, the most contentious area of assessment. The lines are clearly drawn.

7.2.1 Import Liberalization

Some argue that the GOK has gone further in reforming the import regime than its critics allow.

- Import licensing has become much more efficient. Before 1981, import schedules were unpublished, licensing decisions were ad hoc and often weeks in coming. Now each of the 2,700 tariff categories is in one of four well-defined schedules, published annually with tariff and sales tax rates. The lag between application for a license and decision is now only one week for an import license and another for Central Bank release of foreign exchange. Computerization of licensing data allows Government to know the situation on license applications within a month. Import procedures are thus more open, routinized and efficient.

- The number of items on Schedule I has grown from 54 percent in 1983/84 to 65 percent in 1984/85. These are the relatively unrestricted categories.[1] The IMF also considers Schedule IIA (mainly petroleum and food) as relatively unrestricted, in that licenses are almost always issued to meet domestic demand.

- In the second half of 1984, the value of import licenses increased by 20 percent and CBK releases of foreign exchange were up by 31 percent. Schedule IB went up the most. Total imports in 1984 rose by about 15 percent, after four years of little growth. (See Chapter 2 for details.)

- While there has been no overall tariff reform, the average rate of tax collections on imports (tariffs plus sales taxes) was 28 percent in 1984/85, much higher than in 1979-81. Average tariffs are being made more uniform. And the effective devaluation of the shilling has raised import prices in real terms by 14 percent since 1980, which is equivalent to a substantial uniform increase in tariff rates. For a (typical) tariff rate of 35 percent

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[1]Schedule I is divided into IA and IB. The latter was created in 1982 to give flexibility in case of a foreign exchange crisis. It identifies in advance items that can be restricted if an emergency requires it.

> for example, the devaluation has the same effect as a rise to 54 percent. So a growing share of the burden for restricting imports is being shifted to the exchange rate and tariff system.

Critics acknowledge these improvements. They say, however, that the fundamental problem is untouched by such changes. The issue really is twofold: automaticity and reduction of levels of protection. On both counts performance has been inadequate.

The GOK had agreed, as part of the World Bank's SAL I, to replace quantitative restrictions (QRs) with equivalent tariffs, make the tariff structure more uniform and do industrial sector studies to determine a new tariff structure. The first has not been done, the second only modestly done, and the studies were postponed for four years. Under SAL II the Bank extended the date for the new trade regime, and conceded that some QRs could be maintained afterward. The GOK committed itself to reduce the number of items subject to QRs by 20 percent a year. But the 1982 coup attempt disrupted the foreign exchange picture, and Government responded by creating Schedule IB, which limited the list of automatic imports. Government agreed to a "trigger system," whereby imports would be liberalized in line with the state of foreign exchange reserves. But the GOK soon decided that the trigger arrangement was unworkable--the tying of liberalization to reserve levels was an over-simplified approach. A 1983 circular of the Ministry of Commerce also--and more dramatically--gives evidence of an unwillingness to allow tariff reform to increase competition.

> As there is a possibility of having included some locally manufactured items on the free schedule, we wish to request all local manufacturers to study this schedule carefully and then inform Governments in writing of any misplacement of items. The Government will consider reassigning these items to other, that is, restricted, schedules....

There is no inclination toward automaticity here, though it is only part of the reason why liberalization as automaticity is so difficult to achieve. The others are a fear of "hoarding" or overstocking (since importers do not believe that open importing will continue) and the fear of Asian dominance in import markets. (See "Import Management" in Chapter 2 for further discussion.)

The failure to achieve a more open import regime, one not dependent on administrative allocation of licenses and foreign exchange, is one of the two grand failures of the structural reform effort of the past five years. The progress in improving import management is undeniable, as is the fact that imports have increased in volume, with more near-automaticity in granting requests for licenses. But there has been no basic reform of the tariff system, and no indication of a willingness to allow imports that are competitive with local industry. Also, the export promotion effort has been entirely too diffuse and uninspired, reflecting low GOK commitment.

7.2.2 Maize Marketing and the Public Sector

The second failure, of course, is in maize marketing liberalization. The GOK has not allowed a legalization of private trade, reduction in the legal role of the NCPB to a buyer and seller of last resort or a freeing up of grain movements. Proposed new legislation is if anything more illiberal than existing practice. The uncertain mandate of the

KGGCU and its apparent expansionist proclivities raise unfortunate possibilities of an increased semi-state presence in agricultural markets.

On the redimensioning of the public sector, the progressive, forward-looking recommendations of the 1982 Ndegwa Report on Government Expenditures have led only to the creation of two new committees. The GOK has made clear so far that it sees no urgent need to divest unprofitable and/or unnecessary activities and agencies. To the contrary, the evidence indicates a strong preference for risk-avoiding policies, that is, for avoiding unemployment increases and, regionally unpopular closures of parastatals. More generally, the GOK has done little to give increased vigor to the country's private sector.

Progress in these critical areas of structural blockage--trade and industry, agricultural marketing, parastatal restructuring and private sector encouragement--has thus been disappointingly slow and that explains the negative perceptions of Kenyan economic performance that circulates among so many knowledgeable observers.

8. RECOMMENDATIONS

8.1 No Change in Level

The first issue is whether the level of ESF funding for the next phase of the SAP should be changed in the light of this evaluation. More specifically, should the level be cut because of inadequate compliance and the deep U. S. concern over inadequate GOK progress in introducing structural changes needed for faster growth? The future level of ESF of course depends on many factors other than GOK economic performance. But judged even by that standard alone it would be difficult to justify a program cut. As shown in the previous section, the GOK's overall economic policy performance has been good or better than good in many important areas.

Nonetheless, the GOK failure to address adequately its structural problem is a matter of real concern to the U. S. as a friend and partner of Kenya. The fact that it is first and principally a Kenyan problem does not diminish our concern. Unless new sources of economic growth can be found, future prospects are alarming--for Kenya's people and government, and for Kenya's outside friends.

The fundamental problem is this. Kenya has enjoyed certain advantages in recent years. The world market prices of some of its export crops (especially tea) have been relatively favorable since 1982. Aid inflows have doubled in nominal terms since the late 70s, and now total almost half a billion dollars a year. The balance of payments situation has therefore been one of relative ease. Moreover, savings and investment rates are high; domestic savings have been some 17

percent of GDP, and gross investment 25 percent of GDP in many recent years. These are very high by current African or World standards.

Despite these favorable circumstances, growth has been modest--four percent per annum, which means stagnation in per capita terms. (In 1984 there was no growth; agricultural output fell by about 10 percent due to the drought.) It is valid to ask how Kenya's economy can generate faster rates of increase in per capita income in the future (the talk in the MFP is of a minimum of six percent per annum) when external circumstances will probably be less accommodating.

There is in fact no readily apparent answer, and this is what gives special urgency to structural issues. Resources in the public sector have to be used more effectively; the industrial sector (public and private) has to become more efficient and outward looking; and individual energies, skills and capital have to be mobilized more completely. At the same time, the population growth problem has to be addressed more vigorously. Unless these things happen, the economic welfare of Kenya's people, the economic sinews of Kenya's government and the political stability of the society--all will be threatened. And this is not a distant vision; it's an outcome that awaits the generation that comes to maturity in 2000.

For these reasons AID should not give up on structural reform, despite the limited results of its efforts (and those of the World Bank) so far. But approaches have to be adapted to take account of recent experience and local constraints.

8.2 Change in Composition of the SAP

8.2.1 More Off-Budget Projects

More use should be made of off-budget projects, like the one in the 1984 agreement, creating a special financing facility. There are two reasons to prefer this avenue of financing. It allows more freedom for AID to target its programs toward the structural issues, and in particular toward the mobilization of the private sector. And it is a means of providing balance of payments support without dissipating those fiscal pressures that are inducing the GOK to rationalize its public spending.

8.2.2 Focus on Private Provision of Services

The focus in these projects should be on private sector encouragement, and particularly on new projects that use private sector capacity to provide services to smallholder farmers.[1] One specific approach seems worth study: the use of subsidies and small grants or loans to finance decentralization of service provision. Some service provision of this kind is already done in Kenya. The Kenya Breweries outgrower scheme is one example. Since 1972 Kenya Breweries provides credit, extension services, etc. to smallholders associated with it. East African Industries has introduced a similar scheme for oilseeds, and British-American tobacco has a tobacco outgrower scheme. The recently implanted French company that exports green beans to France has similar arrangements. All these agricultural processing industries generate production from farmers by providing them with needed

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[1]These should be in addition to such projects as the agricultural management project and on-lending schemes to channel resources to private traders and other businessmen.

inputs and buying their output. All do research as well, highly focussed on the specific needs of "their" crop, "their" farmers and "their" markets. There are undoubtedly many variants of this approach that might prove feasible as models, or that might themselves be expanded or elaborated on.

- Dole Pineapple is doing private family planning services.
- A Kenyan entrepreneur has set up an operation similar to that of East African industries: providing credit, extension and other services to small farmers willing to grow (and sell to him) sunflower seed. He has hired two Egerton graduates and three assistants to do extension work.
- Private tractor hire services already have a bigger share of the market than the government tractor services. They are much more efficient and capable of easy expansion.
- Kenchick Corporation (poultry) has a broiler outgrower scheme. They sell 200-300 broilers a day to small farmers, who then feed them for 6-8 weeks. They also have 34 contract farmers for whom they provide technical help via two technicians on their staff, and credit also.
- The MEA fertilizer company in Nakuru has a small soil testing laboratory that already provides faster and cheaper soil analyses to small farmers than the GOK laboratories. It allows MEA to do finer blending and results in more appropriate nutrient uses and hence more cost-effective fertilizers.

These are only scattered examples that we were able to find in the very brief time we had to explore such activities. There is enough to suggest that it would be worthwhile to have a deeper, closer look as the first step in a project to finance private proposals aimed at helping smallholders by service provision--private extension services (for example, fertilizer salesmen), credit schemes, tractor hire arrangements, perhaps training and health programs, others. One general approach might be to offer financing of temporary subsidization of new staff. For example, a fertilizer distributor who wants to take

on a few salesmen (read: extension agent) might be given a subsidy of 50 percent of their first two years' salary. A small trust fund could be set up to vet and finance proposals along these lines.

This report is obviously not the place to develop this concept, nor indeed do we know enough about the full range of possibilities, or about the general feasibility and acceptability of the idea. But it indicates that a kind of private potential exists in Kenya is not yet being given attention and is a proper subject for AID experimentation.

8.2.3 Review Technical Assistance Strategy

The earlier observations on technical assistance suggest that some rethinking of strategy in this area is warranted. There is probably too much resident technical assistance in the MFP and MOALD, and it is so good that it has displaced Kenyan staff or deterred its development. What ought to be done is not so clear; the sense that something is wrong is not always accompanied by insight into what should be done to make it better. The matter requires a closer look than we could give it in this exercise.

8.3 Modify the Approach to Policy Dialogue

Policy reform is a new game for aid organizations, at least on the scale now common. Except in the area of economic stabilization, where the IMF has accumulated some experience (and where there's a body of history on U. S. efforts in Latin America in the 1960s) it does not have much of a track record; few lessons or guidelines are at hand.

8.3.1 Lessons and Some Analytic Questions

Some lessons are emerging from experience, in Kenya and elsewhere. Some analytic questions are also raised by these experiences.

First, it is evident that there exist clear political limits on the use of hard conditionality. The U.S. provides money to help friendly countries deal with economic problems. Even if a country does not deal with those problems as the U.S. believes it ought to, the country remains a friend; U.S. political, strategic and humanitarian motives in helping the country remain relevant.

Secondly, there is a well-known contradiction between money and reform. Aid money can ease the process of change, but its availability reduces pressures and incentives to make the needed changes, which are at the least risky and unpleasant. We addressed this problem earlier, in recommending more earmarking of counterpart for off-budget programs. It will not be considered again here.

Thirdly, donor-reformers do not adequately answer one critical question: why LDC governments like that of Kenya do not adopt reforms that AID, the World Bank, and some of their own technocrats recommend? After all, the reformers are presumably competent, experienced and well-intentioned. Yet this government, like so many others, will not make recommended changes that will presumably make their countries and their people better off.

The answer of course is complicated, for there are many reasons governments do not do what donors think they should do. There is bureaucratic and political inertia. Also, most

officials and intellectuals (in Kenya and elsewhere) do not share our belief that markets work efficiently and benignly. They worry about Asian dominance, for example. And Kenyan decision-makers have different preferences and weight them differently than we do; we push efficiency while they give more weight to political risks, and to the ethnic allocation of benefits. The opposition of vested interests is an obvious factor. In some cases there is a lack of sure, technical knowledge on how to design the needed reforms.

The main point is that the explicit conditionality which is so much at the center of the SAP policy reform effort has little to do with most of these obstacles, and particularly the critical belief factors--that markets do not work, or work in favor of special ethnic groups, and that our proposed solutions are technically uncertain.

The policy reform effort should be targeted more directly on the removal of these underlying objections to change. Persuasion and debate--reasoned dialogue--has to be the major instrument; we have to persuade our Kenyan partners that liberalization (opening up grain markets, divesting, encouraging private actors, freeing up imports and favoring exports) will do what we say it will. Moreover, we have to think more about ways to address other obstacles--, for example, the Kenyan preoccupation with political risks, and with ethnic factors. Experiments are underway elsewhere that might be relevant for Kenya. In Mali, for example, a five-year donor pledge of food aid was designed to remove risks of urban supply scarcities during a transition to a liberalized grain marketing system. Some countries are trying out ideas on compensation schemes, providing money and training for disemployed employees of liquidated state enterprises for

example. And the Malaysians are trying to protect Malay ethnic interests during divestiture of parastatals by setting up what is in effect an ethnic trust fund to be responsible for holding equity in privatized companies for the Malay community as a whole.

It is not known whether such programs would make any sense in Kenya. They are mentioned only to illustrate the kinds of issues that have to be addressed if policy reform is to be more effective in Kenya .

Explicit conditionality can in theory play some role in overcoming a few of the obstacles--for example bureaucratic inertia and vested interests. But it ignores most of the others, and what is perhaps most important, it often creates an environment uncongenial to dealing with others. It tends to become contentious, often leads to game playing, and as a result reduces true dialogue.

Greater emphasis, then, should be placed on improving the quality of the dialogue, on making it less contentious, less prone to game playing, broader and deeper. Explicit conditionality should be given a much-reduced place in the next phase. On most of the things that really matter--maize marketing liberalization, a more open trade regime, competition for local industry, shrinking the parastatal presence--reform-minded donors have come near the end of the road on conditionality. The GOK does not seem to be ready to go further or faster. This is clearly so on maize marketing, on import liberalization, on divestiture of state-owned enterprises. On family planning policy it is not clear whether it is policy preferences or administrative bottlenecks that prevent more vigorous and effective action.

8.3.2 Conditionality Options

This situation leaves AID with three options on the kind of conditionality to be included in the next phase of the SAP. (a) The existing conditions can be reaffirmed, with the probability of continued surface compliance, at best. (b) A new set of conditions could be devised, explicit and hard, with improved performance criteria. The assumption here would be that greater "firmness," expressed in harder, perhaps better-defined conditionality, would greater induce GOK movement toward structural change. (c) AID could step back for a time, reducing or eliminating explicit conditions, and concentrating on developing alternative, non-conditional forms of policy dialogue.

It is the third option that we recommend here. It does not mean no conditionality. The Kenyan authorities have to be reminded that the size and quality of the U. S. program depends on structural changes they know we believe to be crucial for Kenya's future well-being. Also, conditionality can and should be included in individual projects.

Moreover, some conditions can be included in a jointly-elaborated memorandum of understanding or letter of intent. The nature and specificity of the conditions included in that document would not be determined by the U. S. but jointly; it would emerge from a preparatory dialogue. One variant of this project is to ask the GOK to prepare its own version of desirable and acceptable conditionality, an IMF-like Letter of Intent or a World Bank-like Letter of Development Policy.

The memorandum of understanding or letter of intent would set out GOK intentions in areas of mutual concern. It could

incorporate some preemptive conditionality. For example, the U. S. might ask the GOK to agree not to allow the KGGCU to become a monopoly provider of agricultural inputs, if that appears to be a real possibility.

Dialogue should be focussed on two substantive and two procedural issues.

- Further liberalization of fertilizer marketing and pricing seems a highly suitable target for continuing and intensified efforts. It has numerous advantages: reform has in fact begun; fertilizer supply is a critical area for development, since it increased access and use is a prerequisite to agricultural intensification; the U. S. has many ways of helping--expanded supplies, guarantee against risk in the transition to a liberal system, supporting kinds of project aid, etc. Fertilizer marketing reform has been in the vanguard of major liberalization in rural markets in other countries (notably Bangladesh).

- The second focus for dialogue should be population policy. A major new project is planned by AID to begin in FY 1985. As noted in Chapter 5:

  > Recent studies demonstrate substantial unmet demand for services in family planning. Thus, strengthened Government recognition of the problem and commitment to finding solutions, coupled with growing demand for services,make the situation conducive to moving population to a central place in programs of structural reforms....

The GOK could be asked to adhere to the achievement of the Performance Target Indicators set out, by mutual accord, in the multi-donor Integrated Rural Health and Family Project, and obstacles to the adherence to these targets could be the subject of ongoing dialogue, possibly in the task force framework to be discussed below.

The two procedural issues are, first, GOK agreement that earmarking of a part of the next ESF transfer is acceptable.

The GOK is, naturally not sympathetic to this approach. It wants aid-generated counterpart to flow into the national budget. It fears budgetary disruptions if other donors begin to earmark "their" counterpart. (The GOK takes the formal position that use of counterpart is a GOK prerogative.) So this may involve delicate negotiations.

Secondly, the Country Team should ask that the GOK participate in the setting up of new or broadened vehicles for policy dialogue. This means creating task forces, bringing together GOK and donor technicians for sustained discussion and study of obstacles to improved performance in key sectors or functional areas--fertilizer marketing and pricing, trade policy and industrialization, family planning policy, possibly grain marketing. The basic notion here is that a process of joint policy analysis and shared elaboration of proposals for change, worked out over months, instead of days, is likely to result in wider understanding of problems and better appreciation of the difficulties in the way of their resolution. Out of it might come better conceived proposals for change, with better chances of adoption by local authorities.

The concept of a task force approach is not new. Something like it is being developed in Somalia and Uganda, and in Kenya the Bank proposed a related kind of approach, though that was to be concerned only with projects. In some of the experiments underway elsewhere, the task forces are given support in various forms--technical assistance for studies, an administrative unit with secretarial help, copiers, a few vehicles, money for travel by officials to visit countries where particularly relevant reforms have been introduced. The task force allows the possibility of that genuine dialogue that

might actually open new vistas and change minds, all around the table. In fact, in Kenya the agricultural sub-committee of the donor consultative group already performs some of these functions, and conceivably could be transformed into one the joint task forces.

The thrust of this recommendation is to reduce drastically the explicit conditionality item as found in the previous ESF agreements. The substantive CPs and covenants would be replaced by a letter of intent or a memorandum of understanding, in the elaboration of which GOK officials would have a leading role. The issues addressed in the memorandum of understanding would be limited to the few substantive and procedural matters outlined above. The agreement would shift focus from the working out and monitoring of conditionality items to the organization and pursuit of intensive dialogue on key issues.

If this approach proves unacceptable, and explicit conditionality is needed--for home consumption or because the Country Team and/or AID/Washington is unpersuaded by these arguments, then some guidelines will be necessary. This is so particularly because AID no longer can piggy-back on World Bank conditionality. The Bank itself is in some disarray on these issues; its staff is groping for new approaches acceptable to the Kenyans and to their own management.

8.3.3 Dialogue Guidelines

We propose the following guidelines:

a) Some well-defined criteria are needed when deciding the issues or problems to be included in a conditionality agenda. The following seem reasonable.

- the policy problem should be an important obstacle to growth of income or welfare.
- It should be something about which we and the GOK disagree.
- The diagnosis of the issue or problem should rest on a technical/analytic foundation that the country team staff finds acceptable.
- We should be in possession of a clear, technically sound proposal for change.
- This proposed change should be politically feasible, though this is so slippery a concept that perhaps"reasonable" is a better word.

b) "Process" conditions should be avoided--i.e., those that usually begin with "continue," "undertake," "improve," "strengthen," "take steps to...," etc. These are rarely monitorable and are especially conducive to surface compliance and game playing.

c) Institutional reforms are not suitable subjects for conditionality. The Kenya Government is trying to improve its budget system, its investment screening, its control over internal and external debt., etc. If it does badly at this it's because of fundamental deficiencies that spring mostly from the conditions of underdevelopment. Nagging or exhortation by outsiders rarely helps. Technical assistance, dialogue, training might help.

d) Design of meaningful conditionality items takes a lot of time and skill. It can rarely be done well by otherwise preoccupied mission staff or short-term TDYers. In most countries, AID missions have for these reasons tended to rely on IMF and IBRD-designed conditions. In Kenya, as just observed, there is presently no stock of Bank conditionality to draw on. If the mission intends to

design a broad program of conditionality now it will have to invest substantial resources in the effort, at least if it wants to move beyond glittering generality types of conditionality.

e) The number of items of conditionality should be small. We suggest the four mentioned earlier--fertilizer policy and family planning on the substantive side, permission to earmark and the creation of task forces on the procedural side. Projects, whether financed from ESF funds or otherwise, can and should expand the effort in privatization.

Finally, the environment for policy dialogue has on occasion been clouded by discussion involving U. S. private foreign investment. We risk sending mixed signals if the Country Team is forced to argue the case for U. S. companies faced with "unfair" mixed credit ("associated credit") competition from other donor countries. This problem might be reduced or possibly avoided if a mixed credit facility existed in Washington, to which U. S. companies might go to find concessional financing that could enable them to compete against similar financing arrangements from other, non-U. S. sources. This is of course not a problem unique to Kenya. But it is worth mentioning it here.